

The VAT treatment of small enterprises

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1 Introduction

Being a multiple stage general tax on consumption, VAT should, by design, be collected on all transactions in the supply chain. A very broad application of the VAT system is paramount to maximise the revenue generating capacity of the tax, in particular in countries where most economic actors are small enterprises. VAT compliance for small enterprises and the administration of these enterprises for the tax administration is, however, a complex and challenging task. These enterprises indeed often have limited resources and expertise with which to navigate the VAT system and may face difficulties in complying with VAT laws and regulations and filing VAT returns. In this paper, we discuss the different policy options that have been implemented by countries to treat small enterprises under the VAT system.

The most common option used by countries for small enterprises is to keep them out of the VAT system by implementing a registration threshold (see section 2.1.).

Because small enterprises may constitute a significant share of the economy of a country, other countries prefer to include as many of them into the VAT system and offer VAT simplification measures to make tax compliance less burdensome. This can be achieved through measures such as simplified VAT registration and compliance procedures, reduced frequency of VAT returns, and the provision of accessible and user-friendly guidance on VAT compliance (see section 2.2.). As discussed in section 2.2., these simplification measures can apply in countries where there is no registration threshold (which means that *any* supplier is included into the VAT system irrespective of their turnover) or in countries that have implemented a low registration threshold.

Finally, providing small enterprises with the option to use simplified schemes for VAT and other taxes (also so called, flat-rate or fixed amount of tax schemes) can help to reduce compliance costs. These measures can have a significant impact on reducing the VAT compliance burden for small enterprises, making it easier for them to comply with their VAT obligations and allowing them to focus on growing their enterprises (simplified schemes, flat-rate or fixed amount of tax schemes are discussed in section 2.3.).¹

With the assistance of technology, another option is the possible that small enterprises are included in the VAT system from the start of their economic activities, as it is in Chile. Section 3 focus on technology tools that can be used to reduce compliance and administration costs and to improve the enforcement of the VATs (e.g. cash registers).

For the purpose of this report, the term ‘small enterprise²’ shall cover any VAT taxpayer to whom a country might consider applying special VAT rules in view of its small/medium size and/or low/medium turnover. This may include both corporate/non-corporate entities and individuals that engage into a business activity. It is recommended that countries issues guidelines as regards when an entity or an individual is considered a small enterprise.

¹ More detail information about the Latin American regimes for small enterprises can be found at Special Taxation Regimes for Taxpayers with Lower Capacity: Theory and Strategies in Tax Policy and Administration in Latin America - 2024 CIAT,

https://biblioteca.ciat.org/opac/book/5885?_gl=1*1sgmmzy*_ga*MTczODA2MjUwNC4xNzE4MTI5MDU2*_ga_MHWDYD6C0X9*MTcyNDE2MDc1Mi43OC4xLjE3MjQxNjE2OTEuNTMuMC4w

² The authors attempted to include a definition of small enterprises, but they realized that depending on what that definition is used for, the parameters to consider may be different.

2 Policy options

2.1 Small enterprise exemption

In this section, we discuss the options for exempting small enterprises to keep them out of the VAT system by implementing a registration threshold. We discuss issues related to the setting of thresholds, voluntary registration, sector-specific thresholds, gradual tax relief through multiple thresholds, and evasion relating to thresholds.

2.1.1 Registration threshold

An essential policy choice in the design of a VAT is the threshold above which businesses must register for VAT. A registration threshold is usually the primary policy instrument for keeping small enterprises outside of the VAT system.

The appropriate registration threshold for a particular country will depend on a number of factors, which may be of different levels of importance for different economies. Considerations should include:

- (i) Effect on revenue: the threshold should be set at a level provide that does not adversely impact on the country's revenue-raising ability;
- (ii) Ensuring administrative efficiency: the threshold should enable tax administrators to focus on enterprise that contribute the greatest share of VAT revenues, which in some countries also requires excluding small-scale farmers from the VAT net;
- (iii) The distribution of compliance costs: the threshold should exempt small businesses to limit the regressivity of VAT compliance costs;
- (iv) Avoiding economic losses: the threshold should be set at a level where marginal administrative and compliance costs do not exceed marginal revenues.

2.1.1.1 Effect on revenue

To collect sufficient revenues under the VAT, the threshold cannot be too high. Some countries, such as Armenia, Madagascar and Singapore, have a threshold of exceeding USD 300,000. Such a high threshold exempts most businesses from VAT and compared to a benchmark VAT threshold, is often a VAT expenditure.³ Further, such a high threshold generally gives rise to competitive distortions between persons below and above the registration threshold. It also results in over-reliance on the tax instrument applied to persons below the registration threshold, which is generally a turnover or presumptive tax. Although simplified taxes, such as the turnover tax, reduce compliance costs, they give rise to tax cascading and significant economic distortions.

2.1.1.2 Administrative efficiency

To allow tax administrators to focus on large businesses, the threshold should not be too low. Some countries adopt a low or even no registration threshold. As a general rule of thumb, ninety

³ A benchmark VAT threshold can be estimated by relying on the model propose by M. Keen & J. Mintz, *The optimal threshold for a value-added tax*, 88 Journal of Public Economics 3-4, pp. 559-576 (2004), but excluding compliance costs.

percent of VAT revenues are collected from ten percent of VAT registered persons. Lowering the threshold to an inappropriately low level is an inefficient policy to obtain additional tax revenues or reduce informality. Broadening the base of the VAT by removing exempt or zero-rated supplies will generally provide greater additional revenues.

Many countries apply special regimes to farmers under the VAT. Farmers are often in remote locations, may not have accurate accounting records, and represent some of the poorest individuals in developing countries. Including small-scale farmers under the VAT may therefore give rise to high administrative and compliance costs. To avoid these consequences, the VAT threshold should be high enough to exclude small-scale farmers from the VAT.⁴

2.1.1.3 Distribution of compliance costs

VAT compliance costs are regressive since, as a proportion of turnover, they decrease with business size. If the registration threshold is too low, small businesses will be required to register and comply with the VAT. Since these businesses may not have accurate or complete accounting records, their cost of compliance may be substantial. An appropriate threshold will reduce the regressivity of VAT compliance costs by not requiring small enterprises to comply with the tax.⁵

2.1.1.4 Avoiding economic losses

Economists approach the setting of a VAT threshold by estimating the optimal threshold for a VAT, taking into consideration the characteristics of the country under study.⁶ This optimal threshold is determined to avoid economic losses, which will generally be avoided if the compliance and administrative costs from having one more person registered is equal to or less than the additional revenues that will be collected from this person.⁷

Although determining actual compliance costs is difficult and economists generally rely on approximated compliance costs, knowing the optimal threshold for a country is useful since collecting tax revenues should be, as far as possible, to the economic benefit of a country. Thinking in terms of the cost-benefits of the registration threshold is useful to inform us what an appropriate threshold level may be.

Once a threshold that approximates an optimal threshold is established, economists revise the threshold to take into consideration economic changes. Especially in high-inflation environments, the registration threshold may need to be raised regularly since without these adjustments, the threshold in real terms decreases over time. To have some indication of changes in administrative and compliance costs, economists sometimes consider the change in GDP per capita over time. GDP per capita is viewed as a proxy for administrative and compliance costs, since these are correlated with the level of development of a country. An

⁴ Excluding small-scale farmers from the VAT may reduce the regressivity of the VAT, but this would depend, amongst others, on the extent of informality in a country, the extent that foodstuffs are imported, and how capital inputs are treated under the VAT.

⁵ Other policy options, such as a simplified schemes and presumptive taxes applied to small businesses, limit the regressivity of compliance costs for other taxes.

⁶ M. Keen & J. Mintz, *The optimal threshold for a value-added tax*, 88 *Journal of Public Economics* 3-4, pp. 559-576 (2004).

⁷ To be precise, it is the social value of the additional revenues and administrative costs that should be considered in determining the optimal threshold.

increase in per capita GDP suggests a decrease in the sum of administrative and compliance costs, which will in terms of an optimal threshold be reflected by lowering the threshold.

Table 1 provides average registration thresholds by region, applicable at the start of 2020.⁸ The average threshold generally exceeds USD 50,000 and is higher in less developed regions with lower per capita GDP than more developed regions.

⁸ Data obtained from www.imf.org and includes data for 128 countries.

Table 1. Average VAT registration threshold by region.

Region	Average Threshold (USD)
Australasia	45,120
Baltic States	184,811
Caribbean	66,918
Central America	37,500
Central Asia	102,865
Eastern Africa	68,478
Eastern Asia	93,292
Eastern Europe	48,897
Melanesia	57,385
Middle Africa	493,206
Middle East	97,988
Northern Africa	69,427
Northern America	22,263
Northern Europe	93,811
Polynesia	72,476
South America	36,425
South-Eastern Asia	190,949
Southern Africa	57,518
Southern Asia	91,956
Southern Europe	15,782
Western Africa	325,325
Western Asia	127,582
Western Europe	50,428

2.1.2 VAT registration

Generally, businesses are required to register for VAT if their turnover exceeds the registration threshold over a period, which is generally 12 months. Each country has its own approach to establishing turnover, with a common approach being that turnover refers to the value of all sales, whether taxable supplies or not. Some countries do not use turnover, but rather taxable supplies to determine whether a business should register for VAT. Businesses only making

exempt supplies would, therefore, not be required to register for VAT or submit VAT returns. This approach has the benefit of reducing administrative and compliance costs. However, since businesses that make exempt supplies would therefore not file returns, VAT return data cannot be used for policy analysis. Policy analysis should therefore be conducted using other sources of data and more advanced methods.

To reduce administrative and compliance costs, rules are required to keep businesses that temporarily exceed the threshold from registering. Common rules would exclude once-off transactions of large value from consideration when determining whether a business should register. Other rules allow businesses to provide reasons that their turnover will only temporarily exceed the threshold.

2.1.3 Voluntary registration

The registration threshold only determines when businesses must register for VAT. If appropriately designed, it does not exempt all businesses below the threshold from VAT. Businesses should be able to select to not be exempt, but rather VAT registered, even if their turnover is below the registration threshold. If not, the registration threshold will give rise to greater competitive distortions and increase informality.

Businesses will generally opt to voluntarily register under the VAT if they predominantly supply to other VAT registered businesses or make zero-rated supplies. Registration allows input VAT to be deducted by the small business and the output VAT charged will be deductible by registered recipients, registering for VAT results in a competitive advantage for businesses predominantly supplying to registered businesses. For zero-rated supplies, including exports, businesses do not charge output VAT but would prefer to be registered to deduct input VAT. Another reason that businesses may opt to register is if they have large capital costs and experience cash flow constraints. Cash flow constraints may force businesses to register even where it may give rise to a competitive disadvantage to do so.

A well-designed VAT system therefore provides incentives to register and enter the formal tax system, which may reduce informality and raise tax collections from other tax instruments, such as the income tax. Since these incentives relate to claiming input VAT, the broader the base of the VAT the stronger these incentives. Applying the VAT to capital inputs and common business inputs such as fuels, water, and electricity, is particularly important to motivate voluntary VAT registration, as businesses once registered would be allowed to deduct VAT on these items. Taxing these supplies will not only raise additional VAT revenues because of a broader base but also raise revenues from other tax instruments because of more businesses being in the formal tax system.

Although voluntary registrations should be allowed, tax administrations should determine the legitimacy of a business before registering it for VAT, considering that VAT registration is the entry point to VAT fraud. VAT provides unique opportunities for fraud, and especially VAT refund fraud may be prevalent and difficult to detect.

To limit VAT fraud, some countries such as South Africa apply a low, voluntary registration threshold where below most businesses may not register. Other countries rely on other requirements that a business needs to meet to show that it is legitimate, such as business licenses and physical presence in the case of Mauritius and third-party data in the case of Ukraine. Irrespective of the approach adopted, objective requirements to establish the legitimacy of a business are required prior to VAT registration.

2.1.4 Sector-specific thresholds

Since the value-added of a transaction varies by sector, and certain sectors such as agriculture and forestry face higher compliance costs⁹ while others, such as professional services, can easily evade the VAT,¹⁰ some countries set sector-specific thresholds. These may also take the form of requiring businesses of a certain legal form to register for VAT irrespective of their turnover, which is effectively a threshold of zero. Separate thresholds for suppliers of goods and suppliers of services are also found in, for instance, Senegal, Côte d'Ivoire, Ireland, France, Algeria and Malta.

Although setting sector-specific or supply-specific thresholds may appear appropriate when only considering tax policy, this approach results in significant administrative challenges. The primary challenge is classification. Determining the sector that a person operates in, or whether a person only made supplies of goods or services, poses a challenge to tax administrators. Without sufficient administrative capacity, businesses can often evade tax registration by arguing or presenting themselves to belong in a different sector. If businesses are not allocated to the sector that they appropriately belong, competitive distortions will arise.

When deciding on a threshold for foreign suppliers that supply electronic services or low value imported goods, the threshold applicable to domestic businesses will generally be appropriate. Although the ratio of compliance costs to turnover of foreign businesses may, on average, be less than domestic businesses, this approach avoids competitive distortions between domestic and foreign businesses. This said, where there is little domestic competition with foreign suppliers or different registration, administration or compliance processes are applied to foreign suppliers, a separate registration threshold for foreign suppliers may be appropriate.

As a general principle of VAT, whether the tax is charged should, as far as possible, be determined by easily verifiable factors alone. It is for this reason that, as often done in developing countries, basing the tax treatment on the use of goods or services, or the nature of the recipient is considered poor policy. Similarly, the difficulty verifying the sector that a business belongs to may give rise to costs that exceed the benefits of sector-specific thresholds. Generally, a single registration threshold that applies to all persons, irrespective of sector or type of supplies made, is considered best practice under a VAT.

2.1.5 Gradual tax relief by multiple thresholds

Another reason why countries may have more than one compulsory registration threshold is to ease businesses into the VAT, or provide gradual tax relief, by providing reduced rates on the supplies by persons below the primary threshold, but above a secondary threshold. Persons with turnover between the two thresholds will charge output VAT at a reduced rate and can deduct input VAT at the rate paid on their purchases, or the rate applied to their supplies.

This practice gives rise to some negative consequences. The primary consequence is the challenges that arise in applying a VAT with multiple rates. Multiple rates raise the compliance and administrative costs of the VAT since they require increased verification to ensure that the

⁹ The compliance costs in these sectors tend to be higher due to operating in remote locations and, in many developing countries, comprising many smaller businesses.

¹⁰ Professional services in developing countries are often cash-based businesses with turnovers or taxable supplies that exceed the registration threshold. Operating in cash eases VAT evasion.

correct rate is/was charged. Multiple rates also increase the likelihood that VAT refunds will arise and, especially developing countries, find VAT refunds difficult to administer.

Another consequence is that competitive distortions that arise between persons charging the reduced VAT rate and those above the primary or general registration threshold, who must charge the standard rate. These distortions will be greater if the businesses charging the reduced VAT rate are allowed to deduct input VAT at the rate paid on their purchases. If input VAT deductions are reduced by limiting them to the rate charged on supplies, this also raises administrative and compliance costs and leads to tax cascading.

Reduced rates for small businesses also distort consumer choices. Since the VAT treatment is inconsistent between different suppliers, similar goods and services will be taxed at different rates, depending on the supplier. Since this results in economic distortions, the overall efficiency of the VAT is reduced. These consequences suggest that gradual tax relief by multiple thresholds should generally be avoided under the VAT.

2.1.6 Registration evasion

Persons evading VAT registration provide an administrative challenge. In particular, businesses that predominantly supply to final consumers will have incentives to avoid or evade VAT registration, particularly if they do not have significant input VAT deductions (for example, service providers whose main inputs are labour). Since final consumers cannot deduct input VAT on their purchases, non-registered suppliers to consumers will generally have a competitive advantage over registered suppliers.

There are two prominent methods of evading VAT registration if a single registration threshold is applied. The first is under-reporting of turnover to remain below the threshold. Liu et al. (2019) show that businesses with less inputs, who face greater competition, and predominantly sell to consumers tend to under report turnover to remain below the registration threshold.¹¹ Although this type of evasion can be difficult to detect, identifying businesses that persistently have turnover below the threshold to be audited is an important first step. Cross-checking VAT return data with other data available to the revenue authority may detect under-reporting. If the threshold is changed, this also presents an opportunity to identify persons whose reported turnover follows the threshold to further investigate the reasons for the observed change in turnover.

The other method of evading the threshold involves splitting businesses into branches that each have turnover below the threshold with the purpose of avoiding VAT registration.¹² As a business' turnover approach the threshold, persons will attempt to evade the threshold by creating a second business, often in proximity to the first. To limit this form of evasion, anti-avoidance rules that do not allow the calculation of the threshold on a branch-by-branch basis or deem multiple businesses to be a single person for VAT purposes are required. Administrators may consider the financial, economic and organizational links of a business to identify splitting of businesses. Further, only providing business licenses to individuals, and not businesses, may help detect this form of evasion since multiple businesses can be linked to the individual.

¹¹ L. Liu, B. Lockwood, M. Almunia & E.H. Tam, *VAT notches, voluntary registration, and bunching: Theory and UK evidence*, 103 *Review of Economics and Statistics* 1, pp. 151-164 (2021).

¹² This method is not illegal in all countries and may in such cases constitute tax avoidance.

Where businesses evaded the threshold or did not register when they ought to, rules are required to determine the VAT liability of these businesses. Some countries deem such businesses to have been registered for VAT from the date registration was due. Businesses are then required to re-invoice all supplies from the date registration was due and the VAT over the tax administration. Other countries may make a deemed assessment of the VAT payable. Penalties are also common.

While determining appropriate rules to limit evasion, not overburdening businesses with excessive documentary and other requirements is important. A balance between limiting threshold-related evasion and limiting compliance costs and other disincentives towards registration is required. VAT registration regulations should be kept as simple as possible, while limiting legal uncertainty. In more developed countries, requiring electronic invoicing may provide further robustness to tax administration.

2.2 Administrative simplifications for small enterprises within the VAT system

In this section, we discuss policy options that may improve compliance, reduce compliance costs, or simplify the standard VAT regime for small enterprises that are registered.

Simplification measures may apply in countries where there is no exemption from VAT for small enterprises (the exemption for small enterprises or “registration threshold” discussed in section 2.1). Simplifications may also apply in countries where there is a registration threshold. In the latter case the simplifications are targeted for enterprises that are below the registration threshold but opt for voluntary registration,¹³ as well as for enterprises having a turnover exceeding the registration threshold, but still considered as being small enterprises that should benefit from simplifications. In this case a second threshold must be set to determine which small enterprises may benefit from simplifications.

Example: If the exemption threshold is set at USD 10.000 (annual turnover), simplifications could apply to small enterprises whose annual turnover ranges between USD 10.000 and USD 100.000.

2.2.1 Simplifying VAT obligations

2.2.1.1 Registration process

Registration is a crucial step because this is the moment when taxpayers are “entering” the VAT system.

It is undisputed that tax administrations need to collect and verify data regarding the taxpayers before they can validate a registration. Nevertheless, registration should not become an unnecessarily cumbersome process. If the burden associated with registration is too high, this may indeed jeopardise the whole process. In contrast, it is widely acknowledged that simple registration procedures increase the level of compliance to the registration requirement.

¹³ Being VAT registered enables the taxpayer to recover their input VAT. This is a great incentive to convince small enterprises to enter the VAT system.

Too complex registration procedures may also lead to errors. If these errors lead to sanctions for the taxpayers, it may also cause frustration and distrust in the tax system and administration.

Accordingly, the right balance should be struck between what the tax administration needs to monitor the functioning of the system and to avoid abuse and fraud and what small enterprises may legitimately be expected to provide. The practicalities of the registration process (online versus offline options) are also of utmost importance.

It is therefore recommended to limit the requested information to what is necessary to clearly identify the small business and to ensure the collection of the VAT. This should be limited to:

- The full name and date of birth (DOB) of the natural person and the national ID card number (if applicable – not applicable if legal entity);
- The name of the legal entity and full name and DOB of the natural person legally representing the legal entity (if applicable – not applicable if natural person);
- Postal and registration address + name and contact details (email address + telephone number) of a contact person for the tax administration as well as and all relevant tax reference numbers of the owners/shareholders;
- Website of the business entity (if applicable);
- The sector in which the business activities fall e.g. agriculture, construction etc.;
- Date of commencement of activity;
- The date that it is liable to register for VAT;
- Bank account details
- Any reference number with another regulated authority (if applicable);
- Turnover during three previous years (if applicable – not applicable for new businesses);
- The value of expected sales to be made in a predetermined period e.g. 12 months from date of registration, alternatively the value of sales made in a prior period that requires a VAT registration;
- Expected percentage of exempt activities (if applicable);
- Expected application of reduced VAT rates (Y/N and which ones).

Both an online and offline options should be considered for the actual submission of the registration request. In practice an online form on the tax administration website *and* paper forms to be sent by mail or email, or submitted directly at a tax office should all be acceptable forms of registration.

Some countries require the appointment of a fiscal representative for taxpayers as a prerequisite for registration, particularly foreign taxpayers, to register. This adds a layer of costs, complexity and administrative burden. Moreover, in many cases it is almost impossible to find a person/company willing to act as a representative due to joint and several liability risk for that company. The requirement to have a fiscal representative may also be counterproductive as, while it does not help addressing the situation of those that avoid registering, it provides a disincentive to them registering in future.

2.2.1.2 Tax returns

The tax return is typically structured in two main parts:

- VAT collected by the taxpayer (output VAT)
- VAT incurred by the taxpayer (input VAT)

Further breakdowns are required to enable the tax administrations to understand how the taxpayer calculated these respective amounts and to reconcile the numbers. However, it is once again recommended to keep the number of *boxes* to a minimum, in particular for small enterprises, in order to facilitate and therefore increase compliance. Explaining why each piece of information is necessary, for example in the form of guidelines published on the tax administration website, may also increase acceptance and compliance by the taxpayer.

In order to monitor the correct application of the VAT, the information that must be reported to the tax administration can be limited to the following:

- Total amount of output VAT collected during the taxable period?
- Total amount of deductible input VAT incurred during the taxable period?
- Turnover related to supplies in which the taxpayer applied reduced VAT rates (and which ones) during the taxable period?¹⁴
- Turnover related to supplies in which the taxpayer applied exemptions (without a right to deduct) during the taxable period?¹⁵
- Turnover related to exports or other supplies subject to a zero-rate made during the taxable period?¹⁶
- Expenditure related to supplies in which it is the customer was liable to self-assess the VAT (domestic reverse charge) during the taxable period?¹⁷
- Turnover related to supplies treated as domestic supplies in a foreign country during the taxable period, in relation to which a right to deduct is exercised?¹⁸
- Amount of adjustment notes issued during the taxable period?¹⁹
- Amount of adjustment notes received during the taxable period?²⁰
- Amount of VAT deduction adjustment in favour of the Treasury?²¹
- Amount of VAT deduction adjustment in favour of the taxpayer?²²

It is further recommended to:

- Allow taxpayers to submit paper and electronic tax returns.
- Allow for the possibility not only to submit returns online but also to *fill in* online returns (in an electronic format).

2.2.1.3 Invoices

The obligation to issue tax invoices in B2B transactions is linked to the monitoring of the VAT deductions made by the taxpayers throughout the supply chain. Taxpayers usually need tax

¹⁴ This information is necessary to understand how the total amount of output VAT was reached.

¹⁵ This information is necessary because when such supplies are made, the taxpayer does not have a full right to deduct.

¹⁶ This information is necessary because in this case there is no related output VAT, but the taxpayer probably incurred expenses (with input VAT) for which they will require a deduction. In the absence of information regarding these supplies, the amount of input VAT may seem disproportionate as compared to the amount of input VAT.

¹⁷ Id.

¹⁸ Id.

¹⁹ This information is important because in this case, a reduction of the output VAT is made by the taxpayer.

²⁰ This information is important because in this case, the taxpayer is required to adjust the input VAT deducted in relation to this amount (if VAT was applied on the supply).

²¹ This information is necessary to monitor adjustments made by the taxable person (in case of credit notes received or other corrections to the right to deduct).

²² This information is necessary to monitor adjustments made by the taxable person (in case of credit notes received or other corrections to the right to deduct).

invoices to support their deduction claims. Tax invoices should therefore include the information necessary to determine whether the right to deduct was legally exercised. At the same time, the invoicing process should remain simple.

To reach that objective it is recommended to only require the following information on tax invoices issued by small enterprises:

- A serial number²³
- A date of issuance²⁴
- The name and VAT number of the supplier²⁵
- The name and VAT number of the customer²⁶
- The date of the supply²⁷
- The nature of the supply (description should be detailed enough and include location if relevant)²⁸
- The net price, the VAT rate applicable, the VAT due and the price including VAT²⁹
- If applicable, the legal provision according to which the liability to pay the VAT is switched to the customer (domestic reverse charge)³⁰

It is also recommended to:

- Allow both paper and digital invoices (for digital invoices, both PDF and XML formats should be accepted).
- Provide a template on the tax administration website.

2.2.1.4 Record keeping

Taxpayers must keep records of their transactions for audit purposes. If the tax limitation period applicable is long, this implies that taxpayers will have to keep records of their transactions for a long time. This may be complex to achieve for small enterprises that may have difficulties to store and protect their records. In order to minimise the financial burden related to record keeping obligations, it is therefore recommended to adopt reasonably long limitation period/time period during which records should be kept. A shorter period could also be adopted for small enterprises for whom the costs of keeping data are proportionately greater than for larger enterprises.

In order to encourage compliance, a standard record-keeping obligation could also be set that is prolonged in case of non-compliance. Mexico for example applies a record-keeping

²³ This is needed to clearly identify each invoice and make the invoice a unique document.

²⁴ This may be needed to determine the time when the VAT is due to the Treasury.

²⁵ This is needed because only supplies made by taxable persons are in principle subject to (deductible) VAT.

²⁶ This is needed to identify the person who will be allowed to deduct the VAT included on the invoice. In a cross-border situation, the name and VAT number of the customer are needed to determine whether VAT is due in the jurisdiction of the supplier

²⁷ This is needed to determine the time when the VAT is due to the Treasury.

²⁸ This is needed to confirm that the correct rate was applied on the invoice and whether VAT is due in the jurisdiction of the supplier.

²⁹ This is needed to confirm that the calculation is made correctly. In case of application of a reduced rate, some additional mentions may be required.

³⁰ This is needed to explain why in this case no VAT is included on the invoice.

obligation of 5 years to all businesses, which is increased for non-compliant businesses up to 10 years.

2.2.1.5 Payment of the VAT

Cash and electronic payments should be allowed.

2.2.2 Adjusted deadlines and procedures

2.2.2.1 Taxable periods

Under the VAT system, taxpayers are collecting the tax and passing it on to the tax administration on a periodical basis. The longer the tax period, the higher the risk that the taxpayer collects the VAT but does not remit it to the tax administration. At the same time, requiring from taxpayers that they remit VAT at too short intervals is overly burdensome.

In the case of small enterprises in particular, a balance must be struck between the risk of revenue loss (which is smaller than in the case of larger businesses) and the associated compliance burden.

It is therefore recommended to adopt longer taxable periods for small enterprises than for other businesses, e.g. quarterly if the standard taxable period is monthly. Specific taxable periods may also be applicable in some sectors, e.g. the agricultural or the tourism sectors, in order to keep pace with the revenue cycles of small enterprises active in this sector.

2.2.2.2 Refunds

When a taxpayer collects less output tax than its deductible input tax, it suffers a VAT burden that can only be relieved if the situation is not repeated in the next period (i.e. if, in the next period the taxpayer is able to deduct all the input VAT incurred against the output VAT collected) or if a refund of input VAT is offered.

Usually, countries do not pay refunds that are under a certain amount (refund thresholds) for tax administrative efficiency reasons (because organising the refund is costly for the tax administration). Yet, these small amounts can be important for small enterprises where cash flow is typically lower.

Also, some small enterprises may also always be in a credit position, for example because they incur VAT in their jurisdiction for the purpose of transactions that will take place abroad or in relation to exports (and for which no output VAT can be collected in their jurisdiction). For these taxpayers the refunds payable are likely to exceed the refund thresholds, but the refund process may take some time because the refund request is usually made via the VAT return, and the tax period is likely to be longer for small enterprises (see section 2.2.2.1).

To address this situation, it is possible:

- To apply reduced refund thresholds for small enterprises (keeping the related administrative burden in mind);
- To organise separate refund procedures for those small enterprises that sells abroad on a recurrent basis (a threshold based on the turnover related to sales abroad should be set).

- To allow regular exporters, e.g., taxpayers whose turnover deriving from exports is at least certain percentage (e.g. 10%) of their annual turnover, to purchase goods/services without VAT.

2.2.2.3 Time of payment - Cash accounting

2.2.2.3.1 Concept

Cash accounting concerns the time when the taxpayer is required to pay the VAT to the Treasury. Under general rules, the taxpayer will usually be required to pay the VAT at the end of the taxable period during which the supply subject to VAT was made or invoiced. However, it is not because the supply was made or invoiced that the VAT was already paid to the supplier by the customer.

Under the cash accounting method, the time when the VAT must be paid to the Treasury is calculated, not taking into consideration the time of the supply or of the invoice but taking into consideration the moment when the customer pays the VAT to the supplier. With this method, taxpayers do not have to prefinance the VAT.

If the right for the customer to deduct the input VAT arises at the time the VAT becomes due to the Treasury, the cash accounting method also prevents a situation where the customer would already benefit from a possibility to deduct a VAT that it has not yet paid (based on the invoice issued by the supplier but that it has not yet paid).

2.2.2.4 Applicability to small enterprises

Under the general rules, taxpayers may have to prefinance the VAT and wait until the customer pays it. For larger businesses, the cash flow disadvantage related to these rules is usually considered bearable. For small enterprises, in contrast, it may be very problematic.

This is why the reliance on the cash accounting method is recommended for small businesses, in particular in countries where there is no registration threshold. In countries where there is a registration threshold, cash accounting could still be applied to small enterprises below a (second) threshold to be determined.

2.3 Simplified scheme for VAT (Flat-rate or fixed amount of tax schemes)

In this section, we describe the simplified scheme for VAT and/or other taxes, so call also flat-rate, fixed amount or special schemes used in some jurisdictions for small enterprises and discuss the advantages and disadvantages of such special schemes that are meant to apply as an alternative to the VAT system for small enterprises. These systems are therefore different from those described in sections 2.1 and 2.2. and they may also cover other taxes and contributions.

These simplified schemes involve taxpayers paying a fixed amount of tax, a flat-rate or a tax amount that is based on a factor as explain below; in a taxable period (usually monthly, but it can be quarterly or annually). These simplified scheme covers in general not only VAT but also income tax and, in some jurisdictions, other taxes or contributions, such as social security contributions or health insurance. Special schemes were introduced in some Latin American countries at the end of the 1990s.³¹ In the European Union, Spain and Italy have also introduced

³¹ See note 1, chapter III.

a special scheme for small enterprises, and outside the European Union, Belarus and Ukraine among other countries have done the same.

It is important to mention that the main objective of these type of special schemes is not only to collect taxes, but to lower compliance and administrative costs, and to solve the problem of informality for these small enterprises.

2.3.1 Scope

These special schemes apply, in general, to individuals and small enterprises that perform certain economy activities and, that meet certain requirements as explained in section 2.3.2.

Each jurisdiction has different criteria to determine who can be covered by the special schemes. In general, the turnover is the main condition to enter into the special schemes, but the type of activity/activities that the small enterprises carry out are usually also considered. In addition to these criteria, the number of activities and establishments where those activities take place is considered (e.g. Argentina, Costa Rica). The number of employees is a determinate factor in some countries (e.g. Belarus). In other countries, the taxpayer' status for income tax purposes has to be considered (e.g. Spain).

2.3.2 Requirements

The special schemes apply to those who meet certain requirements, here below, we included a list of requirements that countries consider when designing this special schemes.

2.3.2.1 Turnover threshold(s)

In order to be qualified for the special schemes, the turnover should not be higher than a certain threshold(s) based on gross turnover, covering specific activities or sectors. This means that the main condition to enter the special schemes is to have a turnover under a certain threshold. This threshold needs to be adjusted regularly, mainly to consider inflation.

Jurisdictions apply different thresholds for different types of activities. In Argentina, the maximum thresholds to qualify for special scheme of small enterprises are different for the supply of services than for the supply of goods, as the threshold for supplies of services is lower than the threshold for supply of goods. The reason for this difference is that VAT is a general, broadly based consumption tax assessed on the value added of goods and services, so in order to reach the same added value in a sale of goods, a higher turnover must be achieved. In case that the small enterprise performs supplies of goods and services, he needs to take into account his main activity to determine in which category of the special scheme he qualify.

Other examples are, Spain which has a single threshold to be under the special scheme; Peru establishes two thresholds based on turnover or acquisitions per monthly basis and Ecuador has established seven different thresholds based on annual turnover.

2.3.2.2 Activities

Regarding the activities that the special schemes comprise, each jurisdiction has its own limited and restrictive list.

In Uruguay, the list covers around 40 types of activities, for example, handcrafts, maintenance of vehicles, tourist guides, trainers and dog walkers. However, there are also countries that do

not use a list of activities to apply for the special scheme, but instead they use a list of restricted activities, so if the taxpayer is engaged in any of them, they cannot benefit from the special scheme. For example, Ecuador has a list of this type, where activities such as stockbroker, advertising or commercialization and distribution of fuels are excluded from the possibility to be under the relevant special scheme. Another example is Peru, where stockbroker, notaries, travel agencies or passenger transport cannot benefit from the special scheme.

Most jurisdictions do not allow taxpayers who perform cross-border transactions to be included in the special schemes.

2.3.2.3 Number of activities, establishments, or employees

Some jurisdictions also limit the number of activities, the number of establishments where these activities can be carried out and the number of employees that these enterprises can have.

In Argentina, taxpayers under the "monotributo" are not allowed to import goods and may not exercise more than three activities or develop activities in more than three places at the same time. In Costa Rica and Peru, if the small enterprise has more than one establishment open to the public, regardless of the number of activities, it cannot benefit from the special scheme.

In Spain, the special scheme applies to each of the activities carried out by the entrepreneur or professional where the activities must be considered independently. For example, if a small enterprise is registered as performing three activities (e.g. trade in household appliances; trade in building materials; trade of doors, windows and shutters), but only two of those activities are under the scope of the simplified scheme (e.g. trade in household appliances and trade of doors, windows and shutters), the simplified regime applies to each of those two activities carried out by the entrepreneur or professional.

In Belarus, there are several special schemes available for small enterprises:

- the single tax on individual entrepreneurs and other individuals (type of presumptive taxation that is mandatory for certain types of economic activity);
- individual entrepreneurship, which applies to individuals registered as individual entrepreneurs who are allowed to hire up to three employees that are their relatives of the first degree;
- The simplified tax regime (covers VAT and Corporate income tax (CIT)), which does not depend on the nature of the supply but on the following criteria:
 - the average number of employees does not exceed 50 persons;
 - gross revenue does not exceed the registration threshold during the fiscal year; and
 - companies having subsidiaries on the territory of Belarus cannot benefit from this regime.

2.3.2.4 Who can be a taxpayer?

The special schemes, in general, apply to individuals (natural persons) that perform an economy activity and, in some jurisdictions, also to small enterprises that meet certain requirements.

In Argentina, the special regime is open to individuals, sole proprietorships, and undivided estates of natural persons, engaged in primary activities (e.g. farming activities), trade in goods and rendering of services (including professional services, but excluding management of companies and board members) with certain thresholds based on annual turnover.

Costa Rica allows individuals and legal entities to register under the special scheme. In Ecuador, only natural persons can be included in the special scheme. In Peru, natural persons and undivided estates of natural persons are comprised. In Uruguay, both individuals and certain partnerships can benefit from special schemes.

In Spain, the special scheme applies to individuals and enterprises that are consider individual entrepreneurs and pass-through entities for personal income tax purposes (e.g. joint property entities or entities without a legal personality) that pursue certain commercial activities (e.g. restaurant services, repairs, transportation, hairstyling), provided that, in relation to such activities, the enterprise does not exceed the limits established for each of the activities.³²

2.3.3 Taxes covered

The special schemes cover not only VAT, but also other taxes such as income tax and, in some jurisdictions, contributions such as social security or health insurance.

In Argentina, the special scheme called “monotributo” unifies the tax component (that includes VAT and income tax) with the pension component (that includes retirement contributions and health insurance) in a single monthly instalment. Argentinian legislation also exempts the social security component for the first two lowest categories of taxpayers that do not have other sources of income in addition to the respective commercial activity (such as employment income, pension or rents).

Uruguay covers retirement contributions and the health insurance is optional. In Belarus, Costa Rica and Ukraine, VAT and income tax are included. In Brazil, all indirect taxes are comprised in the “Microempreendedor individual” (MEI). In Brazil, the SIMPLES National³³ covers eight indirect taxes (six federal, one estate level and one municipal).

2.3.4 Categories

The categories in the special schemes determine the tax that the taxpayers must pay. This amount could be a fixed amount of tax or an amount of tax that is based on different factors.

³² In Spain, an activity is under the application of the special scheme (simplified) when it is specifically included in the Ministerial Order regulating the special system. The special scheme is applied to all those who meet the following requirements:

- They are (i) individuals or (ii) enterprises using the income allocation regime of personal income tax, provided that, in the latter case, all partners, heirs, co-proprietors or stakeholders are individuals.
- That each of its activities is included in the Order that develops this regime and that the specific magnitudes established there are not exceeded.
- Their income volume in the previous year does not exceed any of the following amounts (when an activity has been started in the previous year, the volume of revenue is raised for the year):
 - 250,000 euros for the total of all economic activities, excluding agricultural, forestry or livestock farming activities.
 - 250,000 euros for the total of all agricultural, forestry and livestock farming activities.
- The volume of acquisitions or imports of goods and services in the previous financial year, excluding acquisitions of fixed assets, does not exceed 250,000 euros per year (excluding VAT).
- Who have not renounced the regime.
- They have not waived or are not exempt from the objective estimate regime of personal income tax.
- No activity is under direct estimation of personal income tax or under any of the VAT regimes that are incompatible with the simplified system.

³³ Simples Nacional is an optional taxation regime that allows the unified collection of municipal, state and federal taxes. In addition to unifying all taxes, the rates are lower compared to the payment of all of them separately and progressively, always calculated based on the monthly gross turnover of the enterprise.

In Argentina, the category is assigned according to the following three factors: (i) the type of commercial activity that is carried out (provision of services or the supply of goods); (ii) if the activity is carried out in a physical establishment: the square meters of the establishment, the total electrical energy consumed and the rental cost of the establishment; and (iii) the gross annual turnover (an estimate of the income obtained from carrying out the activities). Based on these parameters, the “monotributo” is divided in eleven categories with a fixed amount to be paid monthly.

Uruguay has four categories which are also based on gross income, the cost of the rent, and not exceeding the number of establishments with a fixed amount. Ecuador has seven categories based on annual income that is subdivided in eight categories based on type of activities. Each category has a fixed amount to pay monthly. Peru has two categories based on monthly income and the value of acquisitions with a fixed amount to be paid. Costa Rica has several categories depending on the type activities carried out, based on two factors: one to determine income tax and the other to determine VAT, which apply in general over the value of acquisitions over the quarterly period.

Spain considers, among others, the salaried staff, the non-salaried staff, area of the premises and electric power consumption.

2.3.5 Advantages and disadvantages

The special schemes are different in every country that applies it, but the main incentive is to bring into the tax net any businesses that, due to their size or activity, operate in the informal sector because it is costly to comply with the administrative obligations of a regular tax system. The aim is to improve the tax culture in the jurisdiction.

The special schemes are not intended to generate revenue. However, they can result in beneficial for tax administrations to control the large taxpayers through the small enterprises and their acquisitions. Hence, it is good practice for tax administrations to request small enterprises to keep information on the value of their acquisitions (e.g. Costa Rica and Peru).

An advantage of the special schemes when they cover social security contributions and retirement pension or health insurance, is that they provide a minimum coverage on them, as usually these businesses do not have access to them.

The special schemes are beneficial for tax administrations, as they reduce the amount of resources targeted to audit small enterprises (e.g. they are not obliged to issue invoices). Some countries obliged these taxpayers to use cash registers and/or fiscal software to be informed about their turnover, see section 3.2. below.

An advantage for the small enterprises is the low compliance costs to fulfil with the special schemes as their administrative burden is not extensive. This is an incentive to be identified for tax purposes.

A disadvantage of the special schemes is that certain small enterprises may have no incentive to grow, and they may decide to remain in the parameters in order to continue benefiting from the rewards of being part of the special scheme. In South Africa, for example, the list of exclusions prevents most start-ups from opting for this scheme.

Certain countries depending on the way the tax administration is organized could have an issue when intending to implement this type of schemes. Some countries have a tax administration at the federal and provincial level or have different authorities to administrate VAT and income tax. It can get even more complicated if the country decides also to include social securities contributions as mentioned in this section, as in general, countries have a different authority to administrate them.

3 The use of technology for assisting small enterprises and tax administrations

In this section, we discuss how technology can be used to reduce compliance and administration costs and to improve the enforcement of the VAT. We will in particular focus on technology tools (e.g. cash registers) underlying the simplifications/special regimes discussed in section 2.1, 2.2 and 2.3 will be directly discussed in these sections.

E-invoicing will be covered in a dedicated paper and will therefore not be discussed in detail here. In this section, we will refer to the paper on the use of new technology to improve VAT compliance, which also includes information about small enterprises.

3.1 Background

Technology enables small enterprises to consistently calculate, report and remit taxes faster, easier, and in a more affordable way. Small enterprises have more limited resources to focus on tax compliance, often without full time headcount dedicated to tax, or the budget to engage specialist tax advisers. Notwithstanding these limited resources, tax compliance is especially key for small enterprises, as the cost of non-compliance (including but not limited to assessments, interest, penalties and the cost of remediation) can significantly impact the cash and cashflow of the business. Small enterprises need certainty on their revenue, margin, and costs, and any unplanned tax exposure can lead to financial and commercial issues. The use of technology can bridge this resource gap and mitigate the risk of getting tax wrong and provider greater confidence and certainty that the business is compliant.

The challenges faced by small enterprises can be further increased when they are not established in the jurisdiction where they have a liability to comply. It is entirely in the tax authority's interest to use technology to make it as easy as possible for a business to voluntarily comply with the compliance requirements it has introduced.

Furthermore, as well as ensuring tax administrations collect the right tax at the right time, there are also additional benefits and incentives for tax administrations. Ultimately, increased use of technology by small enterprises and by tax administrations themselves, allows them to focus their own limited and finite resources on larger enterprises, where there may be more scope for errors, non-compliance, and a larger amount of tax at stake. Technology can also improve the quality of data and provide tax administrations with machine readable data and documents than can help further automate risk assessment, audits and filings.

Technology can make it easier for small enterprises to align tax management into their business processes. The additional incentive for tax administrations to encourage technology adoption and digitalisation is the wider productivity gains including reduced costs for businesses, improved cashflow and increased automation. For tax administrations, it is clear that periodic indirect tax returns do not provide the transparency into transactions needed to identify errors and fraud, and therefore technology is needed to increase the granularity transactional data shared with tax administrations.

3.2 Cash registers and fiscal software

Fiscalization is a system designed to prevent fraud, typically in the retail sector. It involves using specially approved or accredited cash registers or fiscal software to accurately report sales direct to the tax administration. The cash register or software will typically have embedded controls to prevent sales suppression and provide real-time or periodic e-reporting of transactional data direct to the tax administration.

As well as the mandated use of cash registers and fiscal software, tax administrations also have the ability to require businesses to issue a specific fiscal receipt to the customer. This fiscal receipt may refer to the specific cash register or software registration number used and, in some countries, include a QR code or other means for a consumer to validate the transaction themselves. QR code technology allows consumers to take an active role in auditing and validating the accuracy of reporting.

3.3 E-Invoicing

E-Invoicing is the exchange of machine-readable documents between a business and its customers and the tax administrations. This involves a consistent mandated format of the invoice and pre-requisite content. A tax authority can sit in-between the two trading partners, and this provides the tax authority the ability to review, approve and validate, sign and even distribute the invoice to the customer.

Tax administrations can offer small enterprises free of charge access to e-invoicing portals and applications that allow e-invoices to be issued or received, or to manually report or register transactions. This reduces the cost burden for small enterprises and allows them to comply with an e-invoicing mandate without system integration or third party involvement.

Together with data obtained through cash registers and customs declarations, there is an increasing trend by tax administrations to use e-invoicing data to prefill tax returns for review and validation by the taxpayer. An example of country using pre-filled VAT returns by a tax authority is Chile, where the tax authority use data obtained through e-invoicing, and prepare a VAT return that is then reviewed and approved by the taxpayer. However, notwithstanding that pre-filled VAT returns can work well for small and micro enterprises with a limited number of mainly domestic transactions, tax administrations should be aware that there can be challenges in practice, particularly when it comes to medium and large size enterprise companies with a high volume of transactions that are complex and cross-border in nature.

While e-invoicing can provide clear benefits to tax administrators, the streamlined process and focus on clean and granular data can also provide clear benefits for small enterprises too. This includes reducing costs associated with paper and processing PDFs, being paid faster by suppliers, and helping improve accounting processes and tax returns preparation.

3.4 Tax calculation engines

One of the big challenges faced by small enterprises is to correctly classify their goods and services for indirect tax purposes i.e. the relevant rate of VAT, GST or sales that is required to be charged. This is made more complex where there are complex place of supply rules that need to be considered which will determine the jurisdiction in which the transaction is taxed. Standard ERP or accounting packages often don't provide sufficient functionality or rate content "out of the box" and therefore, small enterprises are often required to carry out

significant customization or license a bolt on tax engine solution. While typically a tax engine would be licensed to a business direct by a software vendor for a subscription charge, there are examples of tax administrations subsidizing this or indeed funding this themselves. In any event, it is important for tax administrations to understand the benefit of tax engines including:

- provide a consistent tax calculation policy based on supplier, customer and transactional data.
- provide tax rate, classification and jurisdictional content that is regularly updated
- help small businesses automatically determine and calculate the right rate of indirect tax at the point of sale.

A good example of tax administrations using local Certified or Accredited service providers to provide software and services to determine taxability of goods and services sold by small businesses and calculating the liability and preparing the returns, is the Streamlined Sales Tax project in the US. The ‘Certified Service Provider’ integrates its system with the business's system to determine what is taxable, the applicable state and local tax rates and the amount of tax to collect at the time of the sale. The Certified Service Provider provides free monthly return preparation and filing for the business and is compensated by the State (a US member state of the Streamlined Sales Tax).

3.5 Digital interfaces or portals

There are a number of different digital channels that tax administrations can provide to support small enterprises, reducing the need for traditional assistance via telephone or face-face options. These additional channels are increasingly important where the taxpayer is based in a different jurisdiction. These include:

- webpages setting out clear guidance or frequently asked questions (FAQs) and webforms
- mobile telephone applications
- virtual assistants and chatbots (which can be guided by AI)
- social media channels to provide increased interaction with businesses.
- portals for taxpayers to register for VAT/GST on digital services
- digital mailboxes for secure communications between tax administrations and taxpayers

3.6 Proportionality

Technology is clearly an enabler for tax compliance both for small enterprises and tax administrations. However, tax administration should ensure that any additional compliance requirements involving technology, data or changes in process are proportionate and do not provide excess complexity or cost that outweigh the benefits to both the tax administration or the business. Technology itself is not a silver bullet, but needs to be implemented together with clear and consistent tax policy that can be understood by businesses and implemented without significant cost or major change to business process.