

Review Paper

Tax Incentives in the System of State Financial Support of Economic Entities

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ABSTRACT

In crisis conditions of economic development, it is the state's assistance to economic entities that can improve the economic situation both in the regions and in the country as a whole. The taxation system of business entities should simultaneously stimulate business development and further fill the state and local budgets at the expense of tax revenues. Tax incentives are one of the leading elements of tax policy, which in turn pursue social and economic goals. The research aims to analyze the impact of tax incentives on business entities' functioning and develop options that improve their efficiency and competitiveness. A detailed and comprehensive analysis of the best foreign practices allowed the authors to propose a mechanism for tax incentives in the system of state financial support for business entities. The authors also provided more detailed recommendations regarding individual instruments of state tax incentives and highlighted the most important practical aspects. The proposed recommendations can contribute to the development of business and the growth of innovative activity of economic entities, which will improve the economic situation in the regions and social progress in general through filling the state and local budgets with tax revenues.

HIGHLIGHTS

- ① The system of taxation of business entities should be aimed simultaneously at stimulating business development and at further filling the state and local budgets at the expense of tax revenues;
- ② The most suitable for implementation is the tax regime under which the company is exempt from taxation for a period of three years, provided that at least half of the net profit is reinvested in its own development.

Keywords: Economic Entities, State Financial Support, Tax incentives, Taxes, Tax Revenues

The legislation of most developed countries defines small and medium-sized businesses (SMEs) as a particular subject of state regulation. The specifics of SMEs (social significance, mass character, flexibility) determined the features of their taxation, which is focused on long-term economic development goals and is tied to the actual economic proportions within this sector of the economy. Thus, the basis

of the monetary policy of most developed countries is the postulate of the need to create an equally favorable economic environment for enterprises of

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any type, whether small or large (Shpak *et al.* 2016; Golovchenko *et al.* 2022). Studying the experience of state support of small businesses in developed countries shows that promoting its development is possible only by combining and coordinating various forms, methods, means of regulation, and support. However, in most developed countries' taxation, small and medium-sized enterprises are separated into a separate group, for which unique tax benefits and preferences are provided (Shynkaruk *et al.* 2020). The principle of economic justice explains this approach.

Within any given national system (rather than a theoretical construct), one has to maneuver between fairness, efficiency, and manageability. It is possible to build a fair tax system (or at least one tax), but in this case, such a system or tax will likely be inefficient or poorly administered. Attempts to build a tax system (tax) based on the principle of efficiency lead to a loss of fairness. In reality, something always has to be sacrificed – fairness for the sake of efficiency, efficiency for the sake of fairness, or both for the sake of manageability. One of the critical issues of modern economic theory related to taxation is the problem of determining the optimal (permissible, expedient) level of taxation or the scale of the tax burden in the economy. Analysis of the state of small businesses in Ukraine shows that its further development is impossible without the state's active intervention (Vytvytska *et al.* 2020; Bashynska *et al.* 2022). Therefore, the development and implementation of a well-founded and effective state policy to support the development of small businesses are particularly relevant for Ukraine primarily because it concerns the reform of the taxation system of small enterprises to create favorable conditions for business expansion.

The purpose of the research is to analyze the impact of tax incentives on business entities' functioning and develop options that improve their efficiency and competitiveness.

Theoretical and Methodological Basis

Two areas of research on this problem can be distinguished by the problem of determining the tax burden with a certain degree of conditionality. The first is an attempt to find the optimal level of taxation based on theoretical constructions using a variety of (often very complex) mathematical apparatus. The second direction is also represented

by a relatively wide range of studies in which an attempt is made to determine this level based on the existing practice of taxation and tax systems in various countries. Among the critical issues around which the discussion unfolds is the question of the share of tax revenues in the gross domestic product, the applied optimization criteria, the ratio of taxation of income and taxation of expenses, various aspects of the taxation of income, models of taxation of goods, and many others.

Instruments of tax regulation can be classified as systemic, complex, and local.

The tools of a systemic nature include the means of tax regulation built into the taxation system, namely the general level of taxation, the structure of the current taxation system in the country, and alternative taxation systems.

The instruments of tax regulation have a complex nature, which simultaneously applies to several basic taxes and fees, which creates a special taxation regime for certain groups of taxpayers. These include special tax regimes introduced on a territorial and sectoral basis.

Local tax regulation tools are related to the implementation of the regulatory potential of each tax or fee, which is determined by the selected combination of tax elements and the corresponding procedure for calculating tax liabilities. This group of tax regulation tools includes the following tools: tools related to the object of taxation, determining the composition of taxpayers, and the principles of setting and the amount of the tax rate.

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At the same time, when reforming the tax system, it should also be taken into account that for Ukraine, measures to reduce the rates of basic taxes and significantly increase budget expenditures to stimulate the development of small businesses are unacceptable due to the following factors:

- ♦ Even under stable economic conditions in our country, its social obligations significantly exceed financial capabilities;
- ♦ Lowering tax rates as a tool for stimulating investments in the conditions of political instability in Ukraine will not provide the desired results but will only lead to a decrease in the already limited financial capabilities of Ukraine's budgets;
- ♦ The lack of sources of financing for the budget deficit will not contribute to an increase in expenditures over the received revenues.

Therefore, the taxation system of small enterprises should be aimed simultaneously at stimulating the development of small businesses and at the further filling of state and local budgets at the expense of tax revenues from small firms. The current state of small businesses in Ukraine indicates the need to stimulate its development on the part of the state and, therefore, the continuation of the simplified taxation system. Despite all the shortcomings and arguments against the simplified taxation system, its elimination is not a practical solution because it has an essential social significance in our country. It is also necessary to take into account that the abolition of the simplified system carries the risk of moving into the "shadow" of a significant number of small business entities, which, as a result, will lead to a decrease in the level of small business development and a reduction of tax revenues from the single tax to the budget. A simplified taxation system is a way of so-called "compromise detinization": thanks to the presence of such a system, official registration becomes relatively more attractive, compared to working in a complete "shadow", because it provides legality and minimal legal protection while not requiring record keeping and allowing to pay moderate taxes. As a result, in Ukraine, a relatively more minor (compared to countries with a similar per capita income) problem is the purely informal sector, which consists of unregistered economic units.

Simplified taxation systems of small business entities are not used in the EU countries. Instead, other forms of state support for this type of enterprise have become widespread, namely: the creation of equal conditions for taxation of enterprises of various organizational and legal forms; ensuring

tax neutrality in the event of a change in the organizational and legal structure of the enterprise; the exemption of some enterprises from the need to report on the results of economic activity and the introduction of a simplified system of accounting and reporting; reduction of the income tax rate of small business entities, etc.

There are other forms of state tax support for economic entities, among which stimulation of scientific research and investment activities, provision of tax holidays to newly created private enterprises, methods of encouraging taxpayers - private enterprises for conscientious fulfillment of tax obligations, etc. of particular practical interest. Based on the generalization of the global experience of tax incentives for the development of small businesses in different countries, the following forms of state support can be distinguished (Fig. 1).

As evidenced by the analysis of world experience, in each country, there is a unique combination of forms of state support for economic entities when one or more methods of tax incentives are applied to a greater or lesser extent. As we can see from Fig. 1, even in those countries where the tax system has a neutral character and is built on the principle of equality (USA, Sweden, Holland, Great Britain), there are still exceptions for small business entities.

After analyzing the state support measures provided in foreign countries in the field of taxation for business entities, in particular, small businesses and individual entrepreneurs, the following main forms can be distinguished:

1. Decrease in tax rates. First, this applies to fundamental taxes - income tax, corporate property tax, etc. For example, US tax law provides for two income tax rates for small businesses - 15% and 28%, and corporations - 34% and 46%. The Vietnamese government also cut income tax for small and medium-sized businesses by 30%. This measure has been in place for several years. The state, having declared its intention to reimburse the costs of companies involved in the export of goods, set the task for the government to refund the costs of paying VAT on materials used to produce exported goods.
2. Progressive scale of taxation. Used in countries such as the USA, UK, Austria,

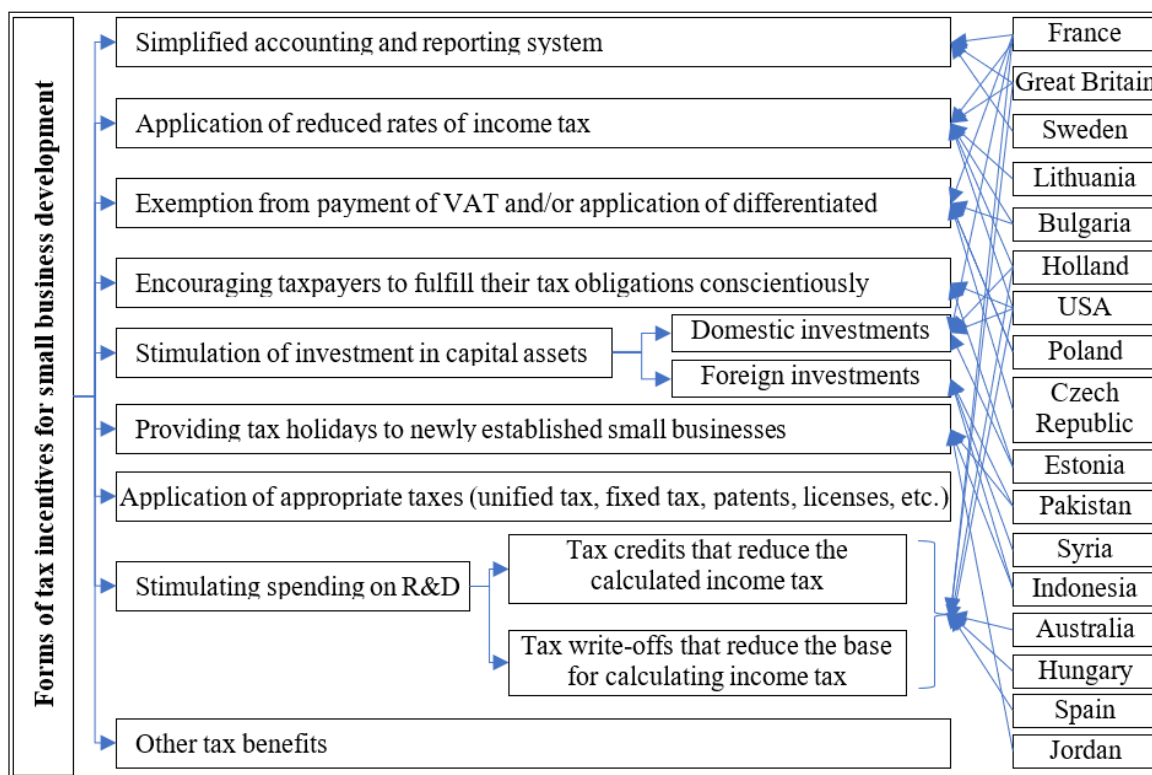


Fig. 1: Forms of tax incentives for economic entities’ development in different countries (adapted from Gavrylenko & Hryshchenko 2021; Malynovska et al. 2022; Shpak et al. 2020)

Belgium, and Switzerland. This measure is noteworthy when using the element of regression of the tax rate for enterprises of the last category (the largest). This, to some extent, prevents the artificial restraint of the economic growth of the enterprise, the deliberate understatement of economic activity indicators, and also creates incentives for the further development of economic entities.

3. “Tax holidays” for income tax. This measure is used in the USA, Germany, France, Sweden, Switzerland, Romania, Slovakia, and the Czech Republic. It aims to facilitate establishing a new enterprise and overcoming the inevitable difficulties of the initial stage of activity.
4. VAT exemption for small businesses with small turnover is valid in England, France, Germany, Sweden, Czech Republic. Where a single tax (under the simplified taxation system) or a small amount of income (turnover) allows exemption from the obligation to calculate and pay VAT, voluntary registration as a payer of this tax is

practiced, and specific benefits are provided for such firms (Great Britain). This allows avoiding situations of refusal to cooperate with small businesses of entrepreneurs who are VAT payers.

5. Introduction of special tax regimes for the taxation of small businesses. This tool is actively used in Western countries (France, Spain), CIS countries, Latin America, etc. Thus, in Armenia, the payment of a simplified sales tax on sales (rate from 7% to 12%) replaces the amount of VAT and income tax and profit tax, respectively, for individuals and organizations.

There is also an integrated approach to solving this issue, which combines the considered techniques within the framework of one tax system. In this case, some tax incentives for individual taxes paid under the general taxation regime are retained by introducing one or more special tax regimes.

Thus, it is possible to improve tax incentives in the system of state financial support of economic entities due to a systematic approach using the best foreign practices.

RESULTS AND DISCUSSION

Studying the experience of state support of business entities in developed countries shows that promoting its development is possible only by combining and coordinating various forms, methods, means of regulation, and support.

The main steps of the state on the way to support the development of small businesses in a world practice are considered to be:

- ♦ The creation of a rational-legal framework;
- ♦ Improvement of the simplified system of accounting and reporting of small enterprises;

- ♦ Organization of financial support for small businesses;
- ♦ Providing small enterprises with information and trained personnel.

Analyzing foreign experience and best practices, we will propose a tax incentive mechanism in the system of state financial support for economic entities (Fig. 2).

One of the most critical aspects of state support is infrastructural support: the provision of free consulting services on legislative, technical, organizational, and financial issues for start-ups and existing entrepreneurs at various stages of

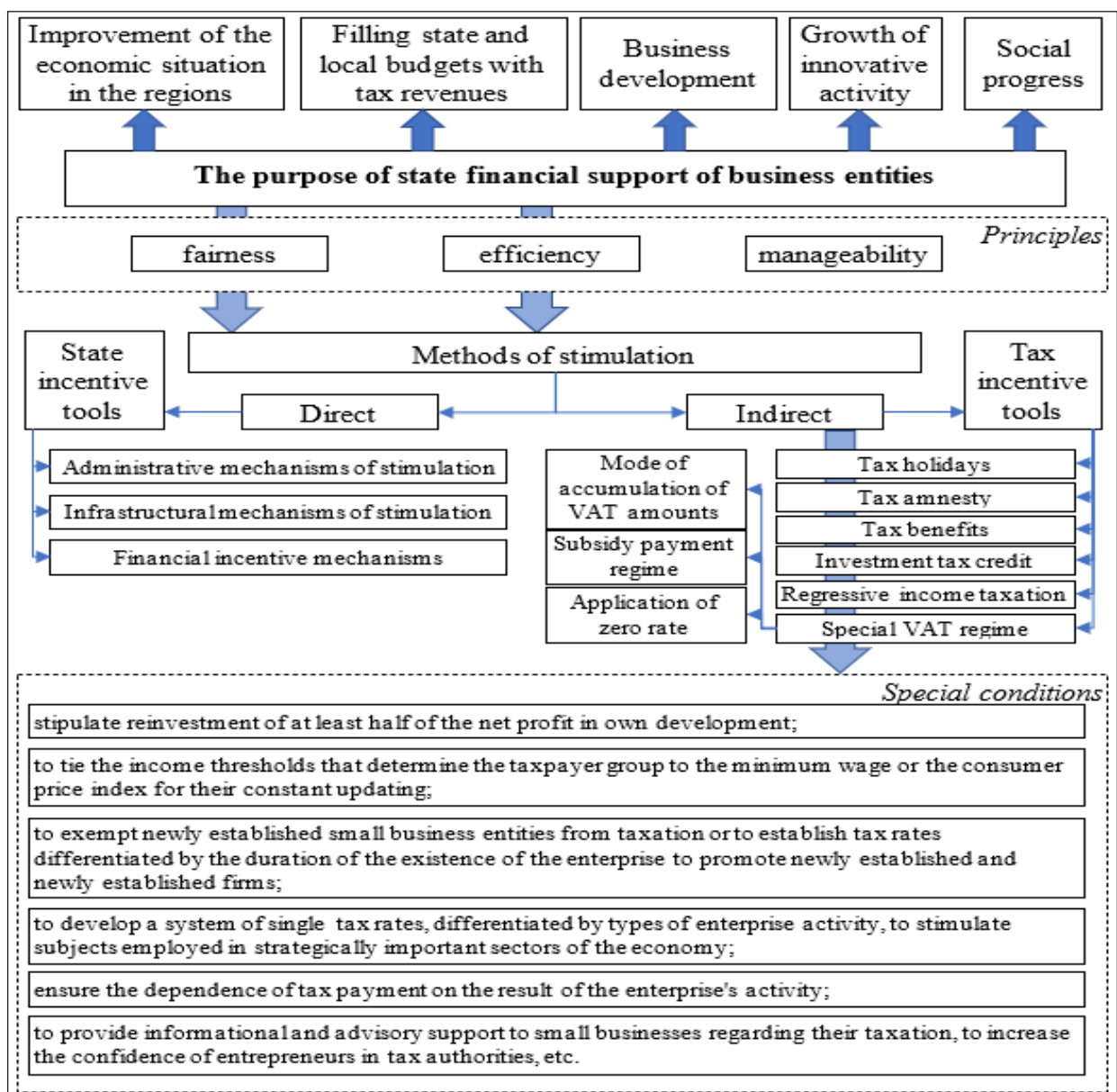


Fig. 2: Tax incentives in the system of state financial support of economic entities (developed by the authors)

development of business entities; organization of training of entrepreneurs in the field of marketing research of foreign markets, search and selection of foreign partners, knowledge of foreign languages; facilitating the establishment of intercompany contacts and advanced training of specialists and administrative staff in the implementation of the cluster policy, environmental safety of products.

Many entrepreneurs do not start a business precisely because of fear of punishment due to incorrect tax deductions, tax audits, and so on. Foreign practice has shown that more detailed consulting in the early years and the absence of severe penalties due to mistakes stimulate the creation and development of business no worse than other government tools.

Thus, the most practical implementation is the tax regime under which the company is exempt from taxation for three years, provided that at least half of the net profit is reinvested in its development. Such a regime will contribute not only to the development of a small enterprise but also to the growth of tax revenues to the budget and the development of the country's economy as a whole. At the same time, we propose introducing this tax regime for newly established small enterprises and all business entities that can use the simplified taxation regime. This will lead not only to the creation of a significant number of new firms but also to the rapid development of already existing ones, their growth into medium-sized businesses, and, as a result, to the economic growth of Ukraine in general.

CONCLUSION

In economic development conditions, state aid to small businesses can improve the economic situation both in the regions and in the country as a whole. Usually, small business entities begin to experience financial losses as early as 2-3 months after the financial crisis.

It is possible to improve tax incentives in the system of state financial support of business entities as follows:

- ♦ Ensure reinvestment of at least half of the net profit in own development;
- ♦ Tie the marginal amounts of revenue, which determine the group of taxpayers, to the minimum salary or the consumer price index for their constant updating;

- ♦ To exempt newly established small business entities from taxation or to establish tax rates differentiated by the duration of the enterprise's existence to promote newly established and newly established firms;
- ♦ To develop a system of single tax rates, differentiated by types of enterprise activity, to stimulate subjects employed in strategically important sectors of the economy;
- ♦ To ensure the dependence of tax payment on the result of the enterprise's activity;
- ♦ To provide informational and consulting support to small businesses regarding their taxation, increase entrepreneurs' confidence in tax authorities, etc.

It becomes evident that a balanced law-making policy in Ukraine guarantees the balance of private and public interest in the conditions of the financial crisis. Modern trends in tax policy are the introduction of favorable tax conditions for doing business through the use of reduced tax rates, postponement of tax payments, exemption from taxation of specific categories of taxpayers, as well as the abolition of a certain period of sanctions for violating certain norms of tax legislation.

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