

The New Portuguese Simplified Tax Regime for Small Business

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This article discusses the motives that the Portuguese chartered accountants considered when having to recommend the new simplified tax regime (STR) that applies to taxpayers subjected to the corporate income tax (CIT). In Portugal, a former STR was applied in the fiscal years from 2001 to 2010. A new STR covering the CIT for small businesses began in the fiscal year of 2014. The data were collected through a questionnaire applied to 315 chartered accountants. 68% of the respondents did not recommend the STR. The main motive for those who recommended it was not a decreasing of compliance costs, but the tax payment reduction that the STR could imply in comparison with the standard CIT regime.

INTRODUCTION

Tax simplification for small businesses has a major objective: compensation for compliance regressive costs that these firms incur. Simplification also encourages tax compliance on the part of small businesses. However, in the design of a simplified tax regime, it is important not to create opportunities for fraud and evasion for these companies (OECD, 2009; World Bank Group, 2007). Small businesses are considered hard-to-tax and are more likely to take advantage of the opportunities of tax non-compliance (Bird and Zolt, 2003; Kamleitner, Korunka, and Kirchler, 2012; Martins, 2010; Mirrlees et al., 2011).

Small and medium enterprises (SMEs) are very important for the Portuguese economy. According to the National Institute of Statistics (2013) in 2011 SMEs represented 99.6% of total companies; with a very significant share of micro business representing 84.7%. Simplified tax regime covers CIT is clearly directed to small businesses, where compliance costs have a significant weight, because they are regressive, and fiscal control is more difficult.

One of the main reasons for the application of simplified and alternative regimes of taxation for SMEs, is the fact that the tax system is too complex for the resources those companies have. Another reason relates to the problems of effectiveness that the Tax Authority may have, to control and monitor the vast number of taxpayers that these companies represent (Santos and Rodrigues, 2006).

Given that STR is optional, chartered accountants are usually the ones who recommend to their small business clients the potential adoption of the simplified regime, because they make their accounting and tax monitoring (Alves, Portela, and Sanches, 2012; Gray and Bannock, 2005; Viola, 2001). Our study will inquire 315 Portuguese chartered accountants using a questionnaire. Our purpose is to find out the

characteristics of STR considered by the chartered accountants when they make recommendations for eventual STR adoption.

The results show that 68% of the accountants did not recommend the STR. Our results also indicate that the main characteristic that influenced the accountants' recommendation is "*the CIT to pay will be lower with the STR compared to the normal regime*" and the "*not required the advance tax special payment*".

This paper is organized into six sections. In the introduction, some considerations on the usual purpose of a STR are exposed. In section two, the issue of simplified tax systems will be scrutinized. In the section three, the new Portuguese STR, which began in January 2014, is addressed. In section 4 the methodology applied in this study is exposed. Section five is dedicated to the results. Finally, in section six, some concluding thoughts will be highlighted.

SIMPLIFIED TAX SYSTEMS

Small businesses usually claim a special treatment, and that is generally accepted by fiscal decision makers (Freedman, 2009; Jousten, 2007). This treatment should not be seen as an exception, but as part of the whole tax process that has its own characteristics. A stable tax system, based on equity, simplicity and efficiency, will always be desirable for all companies, regardless of their size. In fact, small businesses interact with the structure of families, being a way of life and often the basis of their livelihood (Freedman, 2009).

However, some tax reforms include the simplification and the needs of businesses, and in particular of the SMEs. One way of simplification is the introduction of a STR, or just simplifying some accounting, tax calculations or declarative requirements. These special regimes are usually for SMEs and fundamentally arise to reduce compliance regressive costs.

Tax reforms that introduce STR for SMEs do not usually bring revenue increases for the Tax Administration in the short term, since there is usually a decrease in the effective rate tax and these taxpayers have low incomes. But, in the long term, an operative and well accepted STR will lead to an increase in tax compliance and, consequently, to an increase in tax revenues, accompanied by a reduction in administrative costs for the Tax Administration (Santos and Rodrigues, 2006; Terkper, 2003).

The use of presumptive tax and special regimes for hard-to-tax business is an important example of simplification and administrative modernization. However, in some STRs for SMEs simplification can overlap tax equity and economic efficiency (World Bank Group, 2009). The heterogeneity of SMEs may also require differentiation of measures for micro and small business (OECD, 2009). Some STR for small businesses only requires the simplest accounting records or only some books. In other words, the tax simplification is often accompanied by simplifying accounting procedures. The exemption or simplification of some tax obligations is also commonly used, and reduced filing requirements is also a feature of STRs. One of the main objectives will always be the reduction of compliance costs and the administrative costs of business taxation (European Commission, 2007; Pope, 2008; Shaw, Slemrod, and Whiting, 2010).

THE NEW SIMPLIFIED TAX REGIME IN PORTUGAL

In 2013, the Portuguese CIT reform's commission, with a view to competitiveness, growth and employment, proposed a new STR. Law nr 2/2014, of 16 January, enacted the new STR. This new STR began on January 1, 2014.

According to the scope of the STR, firms that can opt for the STR must perform an activity of commercial, industrial or agricultural nature, and verify the following conditions: a gross annual amount of revenues not exceeding EUR 200,000; total assets not exceeding EUR 500,000 and adopt the accounting standard applicable to micro-entities (introduced by the Decree-Law n. 36-A/2011, March 9).

The taxable basis is determined through the multiplication of the different coefficients according to the income nature. The coefficients, according to article 86-B, nr 1, of the CITC, are in Table 1.

TABLE 1
COEFFICIENTS TO DETERMINE THE TAXABLE BASIS

Income nature	Coefficient
Sales of goods and services	0.04
Services rendered by hotels, restaurants and similar activities	
Professionals income	0.75
Income derived from remaining services	0.10
Operational subsidies	
Investment subsidies	0.30
Income derived from contracts object the assignment or temporary use of intellectual or industrial property or the provision of know-how	0.95
Net worth increases (e.g, donations received)	1.00

Source: article 86-B, nr 1 of the CITC.

The computation of the tax base is not based on taxable income determined through the financial accounting system, but by the coefficients listed in Table 1. This STR is considered presumptive tax nature (Ribeiro, 2009). When calculating the tax base, taxpayers who opt for the STR are not subjected to the payment of municipal surcharge. Tax losses which have been borne in previous tax years to the STR application, cannot be carried forward. However, in the case of going out of STR, the taxpayer can then deduct the tax losses that are still within the carry over period.

The STR cannot be opted in when the respective requirements are no longer verified, or the taxpayer withdraws the application by statement of changes, or when the taxpayer did not comply with invoicing duties as stated in the VAT Code. The effects of termination of STR relate to the first day of the tax period in which those requirements no longer exist.

Taxpayers are subject to a lighter autonomous taxation of expenses. In the normal CIT regime, a significant number of expenses are taxed, to discourage some cost that are deemed unrelated to business activity: travel, meals, recreational, non-documented, etc. The STR greatly reduces this type of expense taxation.

The limitation of special taxation and deductions to the taxable base can make the tax calculation simpler and could represent a reduction of tax payable.

Another characteristic of the STR, is that taxpayers are not required to pay the special advance tax. However, from the application of coefficients, a minimum tax base must emerge, amounting to 60% of total annual minimum wage, in the amount of EUR 4,242 (EUR 505 x 14 x 0.6) for the year 2015.

The improvement introduced on the new STR (in comparison with the one in place between 2001 and 2010) was the reduction of some coefficients and the reduction of tax base by 50% and 25% in the year of commencement of activity and the next tax period, respectively, to take into consideration lower profitability in early periods of a business activity.

METHODOLOGY

The perception by the chartered accountants of the characteristics that influence the recommendation for the option of the new STR cover CIT, may show which ones are important to their success.

The aim of this study is to answer the following research questions:

Research question 1 – What is the perception of the chartered accountants about the STR's characteristics that positively affect their recommendation on STR adoption to their clients who are small firms?

Research Question 2 - What is the perception of the chartered accountants about the STR's characteristics that negatively affect their recommendation on STR adoption to their clients who are small firms?

Based on previous studies, we have considered different characteristics that could influence accountants regarding STR adoption recommendation.

The characteristics considered that could influence the recommendation of chartered accountants to STR in the study of Marsden, Sadiq, and Wilkins (2012) were the reduction in the tax payable and the minimization of the costs of compliance. The decision was made mainly in relation to the first option, i.e. by reducing the tax payable.

Alves et al. (2012) analysed the option by Portuguese companies related to the STR that applied from 2001 to 2010. They found that such option was due to improved fiscal management, i.e. the tax payment savings. Other possible characteristics presented in the questionnaire for option to STR are: CIT payment is lower than that obtained if normal regime is chosen, easing the calculation of taxable income. Possible characteristics for not opting for the STR are as follows: payment of the CIT in the regular regime is lower than what would result from applying the STR, the accounting and tax obligations are the same in both regimes, real simplification does not follow from STR.

Smulders, Stiglingh, Franzsen, and Fetcher (2012) considered several reasons for not adopting special regimes for small businesses. Possible reasons were as follows: recommendations of chartered accountants, higher taxes using the special regime, rules are too complex and the increase of external and internal costs accounting. The main reason selected by small businesses for not adopting the special regime is that these rules are too complex.

The data collection methodology selected for our study was the questionnaire. It was subjected to pre-test with seven chartered accountants. The suggestions were mostly towards simplification and clarity of the questions. After some modifications, questionnaires were made available online on October 6, 2014, in LimeSurvey platform.

It was requested to the Chamber of the Chartered Accountants of Portugal (OTOC) to make the questionnaire available on their *website*, to be accessible to all chartered accountants. The questionnaire has been available online since October 6, 2014 until December 31, 2014. To address the reduced rate response, which was expected, face-to-face data collection proceeded in the trainings of two associations: the OTOC and the Portuguese Association of Chartered Accounting (APOTEC), in several locations.

We collected 315 valid questionnaires. The data collected were analyzed quantitatively using the statistical program IBM SPSS Statistics V.21.

RESULTS

The Recommendation of STR

Most of respondents do not recommend the STR (68%). The diversity of companies which the chartered accountants provide services to meant that 22.8% of the respondents recommend the STR in some cases and not in others. Only 9.3% of respondents considered to recommend the STR (Table 2).

As in the study of Alves et al. (2012) the option for STR was mostly intermediated by chartered accountants recommendation.

91.6% of the chartered accountants surveyed considered that accounting or tax explanation were necessary to the entrepreneurs to whom they provide services to justify the recommendation of STR. Only seven chartered accountants considered there was no need to make any explanation. These results are in agreement with the study of Marsden et al. (2012) in which most chartered accountants recommended and explained to their customers the benefits of this type of special regime.

TABLE 2
RECOMMENDATION OF STR

	Frequencies	Percent	Valid Percent
Yes	24	7.6	9.3
No	176	55.9	68.0
Some companies yes and others not (chartered accounting for several companies)	59	18.7	22.8
Total	259	82.2	100.0
Missing	56	17.8	
Total	315	100.0	

Characteristics Influencing the Recommendation of New STR

Of the 83 respondents who recommended the new STR, 76 chartered accountants ordered the characteristics that influenced this decision, 26 considered only one option, 10 considered two options and 36 all the options.

The *reduction of tax payable* in the STR compared to the normal regime has been the choice of the majority of respondents, 50 out of the total of 76 (corresponding to 65.8%). The second choice was the “*not required the advance tax special payment*”, 16 out of the total of 76 (corresponding to 21.1%). These two choices remain in the 2nd preferred option (Table 3). Thus we can consider that these two characteristics have greater weight in the recommendation of STR.

TABLE 3
CHARACTERISTICS INFLUENCING THE RECOMMENDATION OF NEW STR

Characteristics	1st option	2nd option	3rd option	4th option	5th option	6th option
Simplification of the tax calculation	5	7	13	9	6	1
The CIT to pay will be lower with the STR compared to the normal regime	50	11	3	1		
Reduce compliance costs	4	3	8	10	11	4
Less likely to tax inspection	1	3	3	3	6	23
Decreases the accounting requirements if adopt the accounting standard applicable to micro-entities		2	6	12	11	7
Not required the advance tax special payment	16	24	7	3	3	1
Total	76	50	40	38	37	36

These results are consistent with those obtained by Alves et al. (2012) with respect to old STR, finding that the option by the STR was mainly based on reduction of tax payable. The same results were achieved by Marsden et al. (2012), in a study for the Australian case, where all respondents opted for minimizing the tax payable as the main reason for recommending special regimes for small businesses.

The simplification of the tax calculation is the item that has more choices but only in the 3rd option and is the third preference in the 1st and 2nd option. From our results, it seems that respondents find that this STR simplifies the calculation of the CIT.

The reduction of compliance costs and of accounting requirements, if the accounting standard for micro-entities is adopted, are the main choices in the 4th and 5th option. For our respondents one of the main conceptual objectives of the STR - the reduction of compliance costs (OECD, 2009; World Bank Group, 2007) - is not in the first three characteristics that affect their recommendation. Possibly, because this STR does not reduce other tax liabilities and therefore does not decrease compliance costs significantly. Finally, the *less likely tax inspection* was left to the last option.

From the results obtained, we supposed that it is possible to answer the research question 1: What is the perception of the chartered accountants about the STR's characteristics that positively affect their recommendation on STR adoption to their clients who are small firms?

The results indicate that the main characteristics that influenced the STR recommendation by the chartered accountants, are "*the CIT to pay will be lower with the STR compared to the normal regime*" and the "*not required the advance tax special payment*".

Characteristics Influencing Rejection of the New STR

Of the 235 respondents who did not recommend the STR, 206 chartered accountants ordered the characteristics that influenced this negative perspective. Of these respondents 66 ordered all the characteristics, 94 considered only one option and 23 considered two options (Table 4).

TABLE 4
CHARACTERISTICS INFLUENCING THE REJECTION OF THE NEW STR

Characteristics	1 st option	2 nd option	3 rd option	4 th option	5 th option	6 th option	7 th option	8 th option
The rules of the STR are too complex	12	5	9	6	11	14	6	17
The CIT to pay will be lower with the normal regime compared to the STR	93	26	7	6	5	3	5	2
Increased compliance costs	4	8	7	12	10	15	16	4
Increased complexity in the relationship with the tax authorities	4	3	7	14	12	17	12	5
No simplification of other tax obligations	8	13	22	13	15	6	4	1
The companies do not meet the requirements to be in the STR	65	27	15	5	3	4	7	6
Legislation of the STR was not available in time	4	10	5	9	6	4	10	24
Does not agree with the coefficients applied to the activity nature	16	20	17	10	9	7	8	7
Total	206	112	89	75	71	70	68	66

The reduction of tax payable is preferred by respondents for not recommending the STR (93 respondents representing 45.1% of total). We can thus infer, that some accountants view the new Portuguese STR as tax saving mechanism, while others see it in an unfavourable light regarding this topic. That is, the chartered accountants actively collaborate in fiscal management (tax savings) of their clients.

The second choice of the chartered accountants is the fact that companies that provide services do not meet the requirements to be framed in the STR (27 respondents representing 24.1%).

The characteristic of "*does not agree with the coefficients applied to the activity nature*" is the third choice in the 1st and 2nd option and as second preference in 3rd option. These results may show that despite the coefficients being adjusted to the activities, the respondents do not consider them to be appropriate. Under the old STR, the inadequacy of the coefficients had also been highlighted, but because it had only two coefficients (Alves et al., 2012; Faustino, 2004). The adaptation of the coefficients to the activities of companies is considered an advantage of this new regime, as the STR can have a fairer application (Madeira, 2014).

The characteristic of "*no simplification of other tax obligations*" and "*increased complexity in the relationship with the tax authorities*" are the preferences in 3rd, 4th, 5th and 6th option alternately. The "*no simplification of other tax obligations*" had already been considered under the old STR as a disadvantage (Faustino, 2004). Increased compliance costs is the main choice in 7th option, which leads us to question whether it would not be preferable to a stable and predictable tax system than a special regime that can bring complexity (Freedman, 2006, 2009).

The characteristic of the "*legislation of the STR was not available in time*" seems not to be most important for the chartered accountants. Possibly, also already consider that normal, by the fiscal instability and high production of legislation in recent years (Sá, 2013).

From these results, we are able to respond to the research question 2: What is the perception of the chartered accountants about the STR's characteristics that negatively affect their recommendation on STR adoption to their clients who are small firms?

The results show that no recommendation to the STR is mainly a matter of "*the CIT to pay will be lower with the STR compared to the normal regime*".

CONCLUSIONS

The STR is an avenue for tax simplification for small businesses, which mainly aims at reducing the regressive compliance costs that they support.

The reform of CIT, in Portugal, introduced a new RST, starting in January 2014. The adoption of this regime is primarily by recommendation from the chartered accountants. In this study, we inquired, through a questionnaire, 315 chartered accountants about the motivations for recommendation of the RST cover CIT.

The results show that 68% of the chartered accountants did not recommend the STR. 91.6% of respondents considered accounting or tax explanation necessary to the entrepreneurs who provide services to justify the recommendation of STR. The results indicate that the RST recommendation by the chartered accountants was primarily due to the saving of tax payable and does not require the advance tax special payment. The chartered accountants collaborate in fiscal management of their clients, in order to get the most benefit the possible. However, the perception of the chartered accountants respondents is that the coefficients for the tax calculation can be improved.

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