



## **Tax Incentives for Small and Medium Businesses in European Union Countries in the Crisis Period**

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### **ABSTRACT**

In the majority of world countries in all areas of economy small and medium businesses (SMBs) account for a considerable share in the total amount of the gross domestic product, production of goods and provision of services. However, the main thing is that SMB allow to provide the population employment and stable development of the country as a whole. That is why today issues related to organizing an optimal system of SMB taxation for the purpose of contributing to the development and agreeing with the interests of the state, the society as a whole and entrepreneurs remain urgent. The article generalizes the global experience of tax regulation of SMBs development and defines the peculiarities of its taxation focused on long-term goals of economic development. As a result of the conducted research, the macroeconomic essence of the impact of taxation on the development and functioning of SMB was defined. Contemporary world tendencies of using mechanisms of taxation in the system of tax regulation of SMB were analyzed. Top-priority areas of using mechanisms of SMB taxation were defined and generalized taking into account peculiarities of economies of European Union countries.

**Keywords:** Small Business, Small and Medium Business, Economic Development, Tax Regulation, Tax Incentives

**JEL Classifications:** M21, H25, L25

### **1. INTRODUCTION**

In the market economy small and medium businesses (SMBs) defines tempos of economic growth, structure and quality of gross domestic product (GDP). In all developed countries the share of SMB is about 60-70% of GDP. Tax methods and levers that include tax incentives acquire an important role among the tools of state regulation of economic processes, including those in the development of SMB. The development of contemporary national SMB witnesses about the insufficiency of using such levers and causes the necessity of their improvement (Gritsunova and Lotareva, 2015).

Support and stimulation of SMB is a top-priority of taxation policy of the majority of developed countries as well as developing

countries, and countries in transition. SMB are an integral, objectively required element of any macroeconomic system. Economy and society as a whole cannot properly function and, moreover, develop without such system.

The development of business is possible only under conditions of providing effective competition, creation of favorable climate and rational support for the state, and efficient operation of market mechanisms. The peculiarity of business entities functioning is the necessity to form favorable specific environment for their successful development.

According to the global experience, one of the most important and stable peculiarities of the contemporary policy in the area of business is its deploying on the practice of purposeful state support,

especially small business patterns. The level and scales of such support considerably differ in various countries. To a large extent they depend on specific models of the national market economy.

Foreign countries have got large experience of state support for SMB, what is more, not only on the national but also on regional level. Almost in all countries basic areas of state support for SMB include legislative, financial, consulting, informational, and educational support for businessmen, as well as state direct or indirect (for example, via large enterprises) allocation of orders for products (work, services) of small enterprises.

In Russia SMBs make up about 25% of the total volume of the turnover of products and services provided by enterprises in the country. The share of SMBs in the GDP in Russia is 20-21%. Along with this, the level of provision of small and medium enterprises with fixed assets remains low. Small and medium companies possess only 5-6% of the total volume of fixed assets and form about 6% of the total volume of investments in capital assets (Report "On Measures Related to Development of Small and Medium Entrepreneurship in the Russian Federation").

In connection with the development of SMB, it is necessary to consider the perspectives of using efficient tools of tax regulation of the development of small business taking into account the experience of foreign countries, particularly the EU countries.

## 2. METHODOLOGY

The European experience of tax incentives of the SMB development witnesses about the widespread use of various means of its tax support. In the majority of developed countries tax incentives of the development of SMB subjects is provided by applying a set of tax advantages.

They particularly include tax holidays, decrease in the tax rate, special procedure of accruing tax amortization, use of a method of taxation accounting that is more acceptable for payers, increase in the duration of the tax period, special tax discounts and tax credit, and simplified procedure of administering, accounting and reporting. At the present time countries in transition are more characterized by applying special tax regimes that are called alternative (simplified) systems of taxation.

Let's try to clarify the peculiarities of applying the above methods of taxation policy and specificity of their operation.

Tax holidays used to be one of the popular tools of tax incentives of SMB in the 80-90s of the previous century. This preference was usually introduced for small enterprises since the moment of their registration. However, later on the practice showed its inefficiency.

The thing is that under such variant of providing the preference and under relatively cheap and simple system of registration, there is a risk of using tax holidays as a method of avoiding paying taxes. The period of functioning of some small enterprises strangely coincided with the duration of tax holidays, and after that the same

founders registered a new small enterprise. That is why now for these purposes in Europe tax holidays are almost not applied (the only exclusion is France where they are allowed not for those enterprises that are established but for those that have already been working for a rather long period of time on the market of small innovational enterprises (Kesti, 2014).

Decrease in the income tax rate was the most widespread in the states that do not apply alternative (simplified) systems of taxation. As a rule, this preference is limited by the maximum size of the taxation base for this tax whose exceeding automatically increases the tax rate or for the whole taxable income or for the part that exceeds the maximum level.

In the majority of the developed countries of the world by the mid-90s of the XX century, the income tax rates reached their maximum. The economic fall and simultaneous aggravation of the tax competition between the states led to a gradual decrease in the income tax rates starting from 1997 to 1998. These processes were mostly expressed in the European Union (EU) countries. It was stipulated by the progressing globalization and European integration processes.

In Spain small enterprises pay the income tax at the rate of 30% (at the basic one 35%), in France it is 19% (33, 33%). In some countries (Great Britain, the USA) the decrease in the rate specially for small enterprises is not established, but is replaced by the general progressive and regressive scale. In Belgium at the end of 2002 the government implemented the corporate tax system reform. The general rate was decreased in two stages: The first stage – from 39% to 33%, and the second stage – down to 30%. For small and medium enterprises the income rate was decreased from 28.84% to 24.25% (Taxation Trends in the EU).

There is no single receipt of the rational level of the tax rate decrease for small businesses. However, it is considered that in this case it is the most reasonable to establish the tax rate on the level of the individual income tax for taxes from business activity. The main reason in this case is the provision of small enterprises and individual entrepreneurs with equal approach.

Special procedure of accruing tax depreciation: This preference has a comprehensive nature because as a rule small enterprises do not have sufficient investment resources. That is why the use of investment and innovational preferences to support them is quite understandable.

It is necessary to mention at once that this tool of tax regulation is not widely used in the world practice of taxation. However, its use is worth the closest attention. The matter is that the depreciation is the cheapest and consequently the most attractive source of investments financing, because the profits that were changed to them are tax-exempt and do not require conscription expenditures (it is not necessary to pay a percent for using the funds). In addition, re-investment of depreciation provides their growth in further periods and automatically stimulates enterprises for their target use – the reproduction of capital. Additional but important argument in favor of the accelerated amortization

includes the opportunity of partial neutralization of inflation through devaluation of the depreciation expenses.

In Finland a special procedure on accruing the depreciation provides the use of the increasing coefficient 1.5 for general standards of its accrual for qualified investments in statutory funds of small and medium enterprises. In Germany SMB entities have the right for an additional increase in general standards of depreciation of fixed assets. The accelerated depreciation is also applied by small enterprises in Great Britain (Thuronyi, 1996).

Preferences related to the method of taxation accounting are used in some countries whose profits taxation is based on applying “the method of the first event” or accruals method. In order to provide small enterprises with tax support, they are allowed to use the cash-based method that allows to prevent the distraction of proper funds of enterprises in case of supplying goods with subsequent payment. Such procedure is applied in Sweden.

Prolonged duration of tax periods is also one of the methods of tax incentives for small businesses. The example of such preference is the establishment of annual VAT period for small business (Sweden) that can be applied as the payer decides instead of the annual tax period.

Tax discounts and tax credit are traditional methods to stimulate investments and innovations, but in relation to small business they are specific depending on the country where they are applied (Ehtisham and Stern, 1991).

Belgium provides basic tax discount in the amount of 3% of the general volume of investments (except for investments in patents, researches and development of new ecological technology, and investments in energy-efficient technologies whose basic discount for all enterprises is 13.5%) for SMBs. In addition to the basic discount, small enterprises (the number of employees as on the beginning of the year is less than 20 persons) have the right to use a special discount in the amount of 10.5% of the depreciation amount that is accrued for the assets that were invested in the amount of EUR 37,500, but not more than 50% of the profit before tax.

In Great Britain small enterprises have the right to apply the tax discount in the amount of 15.0% of the expenses for researches and developments (with the minimum amount of investments of GBR 10 thousands).

Small enterprises of Spain together with standard variants of the tax credit (that are used by any payers) have the right to apply a special 10% tax credit from the amount of the expenditures for the development of e-commerce, Internet technologies, development of computer technologies and software. Besides, the preference in the form of a tax credit is established for any enterprises that invest funds in non-financial small and medium enterprises that operate in the area of technological innovations. The amount of such tax credit is 99% of the amounts of investments in the venture capital (profit from the sale of shares and other corporate rights).

Small and medium enterprises of Malta have the right for the decrease in the due tax by 65% of the annual volume of investments regardless of their purposes and without any additional terms and conditions.

Norway provides small and medium enterprises with a tax credit in the amount of 18-20% of the expenditures for researches and developments subject to the volume of the relevant expenditures does not exceed NOK 4 million (not more than 8 mln. for universities and other research organizations). Specific amount of the preference depends on the turnover of the company, the balance currency, and the number of employees.

Under conditions of the global financial crisis, the experience of Hungary is worth mentioning. Here along with the 100% tax credit of the amount of investments, small and medium enterprises have the right for an additional decrease in the amount of the tax by 40% of the amount of the interests related to the debt to financial organizations for credits aimed for the production of material assets. Herewith, there is the limitation of the maximum amount of special tax credit. The legislation of the Netherlands also provides a similar special tax credit for small enterprises (Designing a Tax System for Micro and Small Businesses).

Simplification of the administration and reporting procedure: This preference is of special importance for decreasing administrative expenses of small business. That is why it is used by the majority of countries.

Simplified forms of taxation reporting of subjects of small business enterprises are applied in Great Britain, Sweden, Finland and many other countries. Herewith, the area of their application is limited by the utmost annual turnover of the enterprise, and in some cases by the number of employees.

Above all, the simplified procedure of administrating is related to the problem of obligatory registration of small business enterprises as payers of VAT as a tax that is the most difficult and comprehensive in terms of tax accounting. The general rule of almost all states that use VAT includes the determination of the threshold of obligatory registration. Along with this, the actual value of the taxable income whose exceeding is the basis for registering as a VAT payer is not unified, and established by every state individually. As a result, for example, in Great Britain the threshold of registration 30 times exceeds the same indicator in Denmark, where enterprises that have the annual turnover above DKK 20 thousand must be additionally registered as VAT payers.

Having considered the basic types of tax preferences, the following conclusion will be valid: Stimulation of small business in the world practice is based on applying and combination of various tools of tax regulation that are selected on the basis of specific terms and conditions of the activity and priorities of economic policy of relevant countries.

The alternative of the analyzed approach to the tax support for small business within the general system of taxation includes the application of simplified systems (special modes) of taxation of

small business enterprises. This is the way that was chosen by all countries of the former USSR.

At the present time simplified systems and special modes of taxation of small business are particularly used by such states as Byelorussia, Lithuania, and Kazakhstan (Milchakova, 2014). The analysis of parameters of alternative taxation in these countries witnesses about considerable differences in terms and conditions of their application. Besides, the fact that the object of taxation is different is of principle importance: Gross income in Lithuania, gross revenues in Byelorussia, revenues from selling products (goods, works, services) in Ukraine, one quarter of income in the Republic of Kazakhstan, income or income decreased by the volume of expenditures in Russia.

The amount of the single tax for all alternative systems (except Kazakhstan) that were analyzed is not related to the final financial result of the small business operation. Such construction of the tax allows to stimulate rational use of resources, because the payer is not interested in increasing the expenditures for the purpose of decreasing the tax. However, as a whole it is necessary to acknowledge that simplified systems as well as tax preferences that are applied in the general system of taxation considerably differ in terms of almost all its basic elements.

### 3. RESULTS

In our opinion, it is necessary to separately analyze the measures and results of tax incentives used by EU countries to overcome consequences of the global financial crisis. The necessity to overcome consequences of the global financial crisis and renewal of the economic growth made governments of the majority of countries actively use tools of tax regulation together with measures of monetary and credit policy. In the specified period all EU countries without any exception reconsidered their positions related to refusing from preferential taxation. It was reflected not only in the further decrease in the level of taxation of profits of enterprises but also in the implementation of the renewed tools of tax incentives of business activity of companies. Particularly, the average corporate income tax rate in EU-15 countries decreased from 38.2% in 1996 down to 28.7% in 2007, and continued decreasing down to 27.1% in 2010.

Let's consider the main measures taken in these countries in the area of enterprises profits taxation (Paying Taxes, 2012).

In order to overcome the consequences of the global financial crisis, Austria put into force the law about reforming the taxation system (Steuerreformgesetz, 2009). Its principle aim was to decrease the taxation load. One of the measures of this law was to increase tax discounts for enterprises from 10% to 13% since 2010. Besides, accelerated depreciation in the amount of 30% per year was introduced. It allowed this country to get investments in the amount of EUR 700 million for 2009-2010.

Since 2009 Great Britain decreased the rate of the income tax from 30% to 28% and postponed the increase in the rate of the corporate tax for small enterprises planned for 2009 till April 2011. The next

decrease in the income tax rate down to 27% took place in April 2011. Later on it was planned to annually decrease the income tax rate with the interval of 1% every year down to 24% in April 2014. At the same time in April 2012 the standard of depreciation was decreased from 20% down to 18%.

In 2007 due to the world financial crisis The Netherlands decreased the total income tax rate from 29.6% to 25.5% for the period of 2009-2010. The rules related to depreciation accrual and compensation of the expenditures incurred by enterprises were simplified. Besides, taxes for small and medium enterprises were decreased, and simultaneously the amounts of preferences related to income taxation were increased from 10.5% in 2009 to 12% in 2010. The aid for enterprises that were newly established ("startersaftrek") was increased. In order to stimulate the investment activity in 2010 the tax credit for small enterprises was increased and rules for getting preferences by individual entrepreneurs ("zelfstandigenaftrek") were simplified. The rate of the tax for innovational enterprises in terms of taxation of the income earned in the area of research and technological development was decreased from 10% down to 5%. Herewith, the upper limits on the size of the taxable income were cancelled.

In 2007, for the period of 2010-2014, Greece decreased the income tax rate from 29% down to 25%, and provided its gradual decrease by 1% on an annual basis. At the same time, the increased rate of income tax in the amount of 35% (it was based on the income of 2008) was introduced for large profitable corporations.

In 2009 Ireland gradually increased the capital gain tax initially from 20% to 22%, and then since April of the same year – up to 25%. Besides, the terms of paying income tax and capital gain tax for corporations were changed.

During 2007-2008 the Spanish Government decreased the income tax rate from 35% down to 32.5%, and 30% accordingly. For the period of 2009-2011 the income tax rate for small enterprises that maintained the number of employees constant or increased it was temporary decreased by 5%. For the period of 2009-2012 the above payers were also provided with the opportunity to choose the method of depreciation accrual.

Since July 2009 to June 2010 Italy introduced the 50% tax credit for investments in machinery and equipment for small enterprises that earn profit from commercial activity.

In 2009 Luxemburg decreased the basic rate of the income tax from 22% down to 21%, and in 2010 it introduced the self-estimation of the system of corporate taxation.

For small and medium enterprises Germany increased the standard of depreciation for means of transportation as a part of fixed assets, expanded the area of applying the special procedure of accruing the tax depreciation, and introduced 20 percent depreciation of the property cost in the 1<sup>st</sup> year of its use. It allowed to retire up to 45% of the cost of the fixed assets during the 1<sup>st</sup> year. The country provided an opportunity to apply the method of the declining

balance method by any company when depreciating the movable property (the depreciation standard is 25%). The above standards covered basic assets that were acquired or manufactured in the period from January 1, 2009 to December 31, 2010.

In order to support SMBs under conditions of post-crisis economy, in 2009 Portugal introduced a new rate of the corporate tax in the amount of 12.5% for the taxable income that does not exceed EUR 12,500, and decreased the number of pre-payments related to this tax. Besides, tax preferences for investments were introduced – deduction from the taxable income and release from paying local realty tax, sales tax and stamp duty. In 2010 the preferences for payers of income tax were extended. Special amounts of prepayment related to this tax were reduced from EUR 1250 to EUR 1000. This is 1% of the company turnover. At the same time the upper amount of preferences for income tax was decreased, i.e. the amount of the paid tax could not be lower than 75% (before that it was 60%) of the income tax defined under conditions when preferences are not taken into account.

In order to maintain financial state of SMB, France introduced the delay of the tax indebtedness for any enterprises (for 3 years) and provided 4 months delay in paying income tax. SMB got the right to decrease the taxable basis for the income tax for the amount of the losses uncured by foreign branches.

Switzerland decreased the rate of the income tax starting since 2009 from 28% down to 26.3%.

Similar changes in the mechanism of taxation of enterprises income also took place in countries that are new members of the EU during the period under consideration. The average rate of the income tax in these countries decreased down to 19.4% in 2007 and continued decreasing down to 18.3% in 2010. In Bulgaria, when the world financial crisis started, the rate of the income tax was decreased from 15% down to 10%, and in 2010 this rate in terms of taxation of the income earned in the area of gambling industry was increased up to 15%. Such measures led to an increase in the share of income tax in GDP by 0.07%.

In 2009 the Czech Republic temporarily cancelled the previous terms and conditions of taxation of small business (with the number of employees up to 5 persons) and decreased the nominal rate of the income tax down to 20%, and down to 19% in 2010.

In 2009 the Government of Cyprus introduced for SMB the income tax rate on the level of 10% (the previous tax rate was 25%). At the same time the period of 2010-2011 is characterized by the increase in so called “united payment” in the amount of 1%, i.e., the rate of the income tax increased up to 11%.

In Lithuania the income tax rate for the period of 2009-2010 especially for small enterprises was decreased from 13% down to 5%. In 2010 a more favorable mode of taxation of income of agricultural enterprises was replaced by a special rate of the income tax decreased by 10%. It is used for taxation of the income earned from the agricultural activity. Since 2011 this rate was increased up to 15%.

In 2009 Poland intensified its investment incentives. For example, it introduced immediate debiting of funds due to applying accelerated depreciation for small and newly established enterprises registered as payers of the corporate tax.

Since January till June 2010 Romania applied delays in tax obligations related to income tax.

In 2010 Slovenia increased tax credits for investments in the area of research and technological development from the current 20% up to 40% from the amount invested in research and technological development, and gradually decreased the rate of the income tax from 22% down to 21% in 2009, and then down to 20% in 2010. During 2009-2010 measures on stimulating investments were taken. In 2010 new tax preferences for employment were taken (for example, employment of citizens aged up to 26 or older than 55 who were registered as unemployed not less than during 6 months).

In 2009-2010 Slovakia introduced state subsidies and preferences on income tax in the area of research and technological development that were used by the entrepreneurial sector.

So, every EU country developed a complex of measures to overcome consequences of the impact of the world financial crisis (Deloitte Touche Tohmatsu, 2009) that was reflected in the mechanisms of the legal entities’ income tax (Table 1).

## 4. RESULTS DISCUSSION

As a result of the conducted research related to using tools of tax regulation, we have determined the following:

- During the financial crisis and in the post-crisis period all EU countries preferred to fulfill the function of the income tax regulation.
- The diversification and immensity of using tools of tax regulation, reasonability of their timely applying in separate countries are stipulated by different levels of social and economic development, types of the selected model of the macroeconomic development, and levels of impact of consequences of the global financial crisis.
- The most widespread measures of tax regulation in terms of collecting income tax among the countries under consideration include the following:
  1. Decrease in the tax rate (20 countries of 28). Other 8 countries remained the income tax without changes. The exception is only Lithuania and Cyprus. The tax policy of Lithuania was inconsistent: Having decreased the rate of this tax from 18% to 15% in 2008, in 2009 it had precociously increased it up to 20%, and that caused the necessity to decrease the rate down to 15% in 2010. In Cyprus the income tax rate was decreased down to 10% in 2005. For the period from 2010 to 2011 the rate of this tax was increased up to 11%. In our opinion, in terms of fiscal efficiency this measure is acceptable because it does not lead to an increase in expenses for administering the income tax.
  2. Stimulation of investments and innovations (16 countries of 28) is on the second place. Such measure is implemented

**Table 1: Tools of tax regulation provided for income taxation of legal entities**

Countries	Rate of the profit tax		Accelerated depreciation	Support for financial state of enterprises and stimulation of production	Employment stimulation	Stimulation of investments and innovations
	Decreased	Increased				
Austria			+			+
Belgium	+			+		+
Bulgaria	+					
Great Britain	+					+
Hungary	+				+	
Germany	+		+		+	
Greece	+					
Denmark	+		+	+		
Spain	+		+	+	+	+
Italy	+			+		+
Ireland				+		
Cyprus		+				
Latvia				+		
Lithuania	+					
Luxemburg	+					+
Malta	+					+
Netherlands	+		+	+		+
Portugal	+					+
Poland			+			+
Romania				+		
Slovakia				+		+
Slovenia	+				+	+
Finland	+		+	+	+	+
France				+		+
Croatia	+			+		+
Czechia	+					
Sweden	+					+
Estonia	+					

predominantly with the aid of investment tax credits and discounts.

3. The third place is related to supporting financial state of enterprises and stimulating production as well as supporting SMB. The mentioned measures are used in 12 of 28 countries.
4. The use of accelerated depreciation in the taxation accounting is on the fourth place (7 countries of 28).
5. The mechanism of enterprises income taxation (5 countries of 28) to stimulate efficient employment of the population is used relatively rarely. This measure is implemented by decreasing the taxation base by the amount of expenses for education and professional training of employees of enterprises or by applying a lower income tax rate subject to maintaining the number of employees of the enterprise constant or increasing it.

## 5. CONCLUSION

As the history shows, the system of taxation is the main lever of the state influence on the activity of business entities and regulation of social and economic processes. The governments of the majority of countries purposefully use tools of tax regulation both under conditions of the recession and in case of the economic overheating.

In the practice of taxation in the developed countries that stimulate business and above all investment activity of enterprises, taxation

levels are included mainly in the mechanism of profit taxation, and are implemented with the aid of various preferences.

The lack of the same approach to stimulating small businesses by applying simplified systems is stipulated by the specificity of tasks that are solved by every country within such systems. The common peculiarity of alternative systems of taxation is the fact that the unified tax provided by them replaces a part of taxes paid under common (regular) taxation system. Herewith, it considerably decreases taxation and administrative loading on small businesses.

Unlike the national practice, in the world practice the mechanism of taxation of legal entities' profit is actively used when regulating social and economic processes. The improvement of SMB taxation in post-Soviet countries, including Russia, must take into account the European experience of overcoming the global financial crisis.

Therefore, to our mind, in the situation of the longstanding system crisis of economy it is reasonable for the post-Soviet countries especially for Russia to take the following actions:

- a. To decrease the level of taxation of profit of enterprises of the real sector of economy to the level of this tax in the countries that are new members of the EU (on average down to 18.3%),
- b. To provide stimulating levers of the taxation of profits for small and medium enterprises (stimulation of investments and innovations, support for financial state of enterprises and stimulation of production, and the use of accelerated depreciation in the taxation accounting),

- c. To perform taxation stimulation of innovational and investment processes by using investment tax credits and discounts, and
- d. To provide stimuli on paying profit tax by decreasing the profit tax rate down to 5% for small enterprises that maintain or increase the number of their employees if the accrued employees' salaries are not lower than the average salaries for respective branches.

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