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With the right of handwriting

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**The impact of tax policy on entrepreneurship development**

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## **Actualite of the research topic**

The development of entrepreneurship is great importance for the economic success of the country. Elaborated and implemented decisions by the tax policy can have a significant impact on it. Entrepreneurship development strategy largely depends on the tax system in place in the country and its functioning mechanism. Consequently, it is important to analyze each tax legislative change not only at the theoretical level, but also to identify its effects on the position of entrepreneurs and their interrelationships. These studies allow us to see clearly the results of theoretical analysis, how true it is for entrepreneurs in practice. Considering the need to support entrepreneurs to improve their functioning, first of all, it is necessary to identify factors and gaps that hinder entrepreneurial activity, in order to develop recommendations, which will help entrepreneurs to develop their business.

The topic of tax system, tax policy and taxes in general has been devoted to numerous works of Georgian scientists, such as: V. Papava, R. Gvelesiani, R. Abesadze, I. Ananiashvili, E. Mekvabishvili, M. Chikviladze, G. Erkomashvili, M. Tokmazishvili V. Basaria, R. Basaria, L. Bakhtadze, R. Kakulia, K. Adamia, G. Malashkhia, T. Kopaleishvili, et al., which study different directions of a given field. This work is a continuation of the research in this field.

In order to improve socio-economic conditions in the country, it is important to develop entrepreneurship, especially in the small and medium business sector, that will be the guarantee of new jobs. The functioning of the country's efficient and well-functioning economic system depends on the rational tax policy pursued by the state and the efficient operation of the tax system. Therefore, it is necessary to take into account the fairness and correctness of the distribution of tax burden during legislative changes.

This issue is particularly relevant when the scope for implementing the optimal tax policy is limited. In this case the constitutional record is meant (Article 94), which largely limits the scope of reforms implemented. Consequently, legislative initiatives have double importance, because the implemented reforms should not have negative impact on entrepreneurs.

Whereas the new Tax Code of Georgia was adopted in 2010 and entered into force on 1 January 2011, the period of 2011 - 2019 is taken as a period of study of the results of reforms implemented in Georgia.

## **Research goals and objectives**

The purpose of the study is to examine the relationship between tax policy and entrepreneurial policy, assessing the impact of different tax decisions on entrepreneurship development and identify opportunities for tax policy development to support entrepreneurship in Georgia.

Depending on the purpose of the study the following tasks are set:

- Assessing the effects of tax policy and entrepreneurship interactions;
- Study of overseas experience of tax policy to support entrepreneurship development;
- Analyze the results of tax reforms implemented in Georgia;
- Identifying the problems of Georgian entrepreneurs and studying their assessments of legislative changes;
- Determining the ways of formulating tax policies to supporting entrepreneurship development.

## **Research object and subject**

The subject of the research is Georgia's tax policy and its mechanism of operation, the object of the research is to examine the impact of Georgian tax policy on entrepreneurship development, as well the reforms implemented for its improvement.

## **Research theoretical and methodological basis**

The dissertation is based on the works of economic theory scholars, Georgian and foreign scientists, expert opinions, recommendations developed by various international organizations. It uses methods of analysis and synthesis, quantitative and qualitative, historical and logic, induction, deduction and statistics. The work also uses the Georgian Tax Code, bylaws, methodological guidelines. It is also based on statistics and publications from various international organizations such as: Organization for Economic Co-operation and Development (OECD), International Monetary Fund (IMF), World Bank Group (WBG), Eurostat, National Statistics Office of Georgia, Ministry of Finance of Georgia, Revenue Service, etc

## **Scientific novelty of the dissertation**

The findings and recommendations of the research in the form of scientific novelties, are following:

- The main directions of the tax policy, tax systems, reforms implemented and their impact on entrepreneurship of developed countries (USA, EU member states) are studied and analyzed, taking into account long-term perspectives in this field for Georgia;
- There is analyzed and demonstrated the characteristics of the tax policies of the Visegrad countries, the pros and cons of the reforms implemented here and their impact on entrepreneurship development, both before and after the EU integration, taking into account short-term perspectives for Georgia;
- Georgia's tax reforms implemented and their impact of its results on entrepreneurship development are assessed;
- Based on the results of the survey of entrepreneurs surveyed in Georgia, hindering circumstances and causes of entrepreneurship development are identified. In particular: A) Difficult access to credit resources; B) Market insecurity from counterfeit and/or defective products; C) Insecurity of business interests by the government; D) High tax rates, including income tax;
- The impact of Article 94 of the Constitution of Georgia on tax policy is assessed, which in many cases sets entrepreneurs in unequal conditions and is a hindrance to tax policy makers, in order to develop and implement optimal activities and reforms in tax policy;
- Based on the tax reforms implemented in Georgia and the results of the survey entrepreneurs, conclusions and recommendations have been elaborated for the formulation of economic policies to support entrepreneurship development.

## **Practical importance of the thesis**

The findings of this study can be used by the Ministry of Finance of Georgia to initiate legislative initiatives in the area of tax policy. In addition, the findings and recommendations contained in the paper will be important for various legislative bodies, government agencies and the executive. Also,

lecture-seminars for students of higher education institutions such as: 1. Concepts of economic policy; 2. Economic policy in a complex world; 3. Tax policy in the face of modern challenges.

## **Approbation of the thesis**

Dissertation thesis was approved on October 15, 2019 at Iv. Javakhishvili Tbilisi State University, Faculty of Economics and Business, Department of Economic Policy (Protocol N2).

## **Structure and scope of the thesis**

The thesis includes the introduction, three chapters, eight sections, conclusions and recommendations. It is accompanied by a list and appendices of the literature used. The work is presented in a volume of 226 pages printed on the computer. It contains 5 tables and 23 diagrams. The work is accompanied by a list of literature with 139 names and internet resource used with 54 names.

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## **Principal content of the dissertation**

The first chapter of the paper discusses the theories and approaches developed by economists on taxes, tax system, taxation and entrepreneurship. The evolution of the interrelationship between tax policy and entrepreneurial policy in the context of globalization is set forth. The stages of tax policy development are reviewed. The role of tax policy in the development of entrepreneurship is outlined, grounded, how important it is to implement the right tax policy when implementing a specific legislative (Tax direction) direction.

The second chapter discusses the overseas experience of tax policy to support entrepreneurship development. In particular, the tax policy of the United States, the European Union and the Visegrad Countries, the features of the tax system and the principles of its operation are discussed. Implemented reforms, strategies/measures and their impact on entrepreneurship development are evaluated. The example of the Visegrad Countries is analyzed the transformation of the tax system of these countries before and after accession to the EU. The dynamics of changes in the rates of basic taxes (profit, income, VAT) are also evaluated; It discusses the economic policy of entrepreneurship, including SMEs and their impact on entrepreneurship; The share of SMEs in entrepreneurship as a whole is compared.

The third chapter deals with the formation of tax policy to support entrepreneurship development and its development in Georgia. Georgia's current tax system and taxes are assessed. The legislative changes are discussed in detail. The current state of tax policy is analyzed. What strategies are developed by the state for the development of entrepreneurship. What structures have been created for entrepreneurs to make their functioning more successful in the marketplace. The results and contradictions of entrepreneurship development are discussed. The results of the research in



taxpayers are discussed in detail. This study identified their problems and the type of high-pressure tax. The negative and positive effects of the implemented tax legislation were evaluated. The sectors of the economy that need more state support have been identified. Based on the survey of entrepreneurs, tax system / legislation drawbacks and desired legislative initiatives are investigated. Recommendations for Tax Policy Formation for stimulating entrepreneurship development have been formulated.

## **Conclusions and Recommendations**

The development of entrepreneurship is one of the important directions of the economic policy of any state. It is a key guarantee of social, economic and political stability in the country. A rational tax policy and properly selected taxes ensure that there is an effective business environment in the country, Encouraging entrepreneurial entities to start and develop businesses, this, in turn, is the basis for an optimal level of tax mobilization in the country's budget.

The paper examines the evolution of the relationship between tax policy and entrepreneurial policy in the context of globalization, overseas experience in tax policy supporting entrepreneurship development, In particular, tax policy of the United States and its impact on entrepreneurship development are outlined, features of European Union tax policy, implications of tax policy and entrepreneurship interaction before and after accession to the Visegrad Countries.

The tax system of the United States is very different from the tax system of European countries. The United States has three levels of taxation: state, federal, and local, so they are administered at different levels. Taxes are sharply separated by levels of action, therefore, it can be said that the tax system and taxes in the United States are complex. Taxes are different, but one of the major differences it has with European countries is that there is no value added tax (VAT) in the United States, unlike European Union countries and Georgia. Generally, most of the United States tax receipts consist of direct taxes and the main part of the reforms implemented it deals with direct taxes. As for the state of small business in the United States, it occupies the leading position and by 2018 it is over 90%.

Unlike the United States, the European Union focuses primarily on indirect taxes and most of their reforms deal indirect taxes, especially value added tax (VAT) and excise tax. The main areas of European Union tax policy include: Reducing tax burden and tax rates, simplification of tax services

and largely electronic reception/production, establish unified tax dispute resolution mechanisms, prevention of tax evasion, increase tax transparency, developing a fair tax system and automatic exchange of information.

By comparing the situation in the Visegrad Countries, it has been shown that before the accession to the European Union, the countries have come a long way, this was primarily reflected in the transition to the market economy. Privatization of state-owned enterprises was carried out, entrepreneurship based on the principles of the market economy, a number of legislative changes have been made both to support entrepreneurship and to establish general legislative frameworks. SMEs grew rapidly and their share in entrepreneurship, however, they were not sufficiently able to increase employment and value added in relation to large businesses. Therefore, supportive programs are being implemented in these countries in various ways to strengthen the role of small businesses in the economy. In the Visegrad Countries, tax revenues have a larger share of indirect taxes, and the reforms implemented are therefore related to these types of taxes.

The following can be identified as the main areas of tax policy in Georgia: Giving taxpayers some benefits by granting different status, also introducing a profit tax model for certain categories of taxpayers (to help expand their business), lowering tax rates, reducing sanctions on tax offenses, use of electronic services with tax authorities in different areas, etc. This is done to encourage taxpayers, start a new business or expand an existing one, simplify relationships with the tax authority, etc.

Three of the leading taxes in Georgia with its equity participation in the budget receipts in Georgia are: value added tax (VAT), income tax and excise tax. The reforms implemented also affected these taxes. Based on the analysis of the major tax reforms in Georgia and the results of our survey of entrepreneurs, we get very interesting results. Consider each of them separately:

The excise tax change has affected tobacco products, where the rate of excise tax has changed several times since 2015. Finally, an increase in rate of excise tax on tobacco species varies from 75 to 200 percent. Consequently, the import of tobacco products decreased, but nevertheless, the excise tax on tobacco mobilized in the budget has increased. This puts pressure on taxpayers and naturally affects their business, as can be seen in the study, where from negative impact reforms 22% of entrepreneurs reform of excise tax negatively appreciated. There are several risk factors to note: Most of these activities (tobacco production/sale) may move to the shadow economy and therefore lose revenue in the budget; Maybe also from border regions enter excise goods (without excise tax) bypassing customs. The survey also shows that only 7% of entrepreneurs want to reduce the excise

tax rate (The low percentage indicates that the reform target group is not represented in large numbers in the country).

In the context of value added tax (VAT), advances reform was implemented in 2017, which was shown when determining the amount of a taxable transaction, the amount of compensation received is taxable, and the timing of the taxable transaction is determined not later than the payment of compensation or part thereof for the goods to be delivered and/or services to be delivered (Tax Code of Georgia 2010. As of May 24, 2019). This change may have been justified for the construction sector (If the entrepreneur is in the construction business, the proceeds from the sale of his apartments were taxed only when the apartment was put into operation, but with this legislative change, amounts taken by the building owner are treated as an advance and are taxable at the time of receipt, whether the apartment is in operation). However, given that since this has affected on everyone regardless of the type of business activity, from tax reforms having a negative impact this legislative change has been negatively assessed by 61% of entrepreneurs. And for those entrepreneurs who are VAT payers, 63% of entrepreneurs think that this legislative change has had a negative impact on their business. It is also worth noting that 25% of entrepreneurs expressed a desire to reduce VAT rate. In the case of this reform, the negative assessment of entrepreneurs was caused not by the tax rate, but by the determination of the taxable transaction at that rate and its timing.

Introducing Special Taxation Regimes (Micro, Small and Fixed Taxpayer Status) in the Tax Code of Georgia in 2011 and granting certain benefits under the given statuses has a markedly positive impact on entrepreneurs (Since 2018, for an entrepreneur with small business status, the upper limit of gross income increased and the tax rate decreased). By granting these statuses, entrepreneurs are able to obtain the appropriate status based on the gross income earned per year. It should be noted that the entrepreneur with the status of micro business does not pay income tax (upper limit of gross income of GEL 30,000), an entrepreneur with a small business status is paying 1% or 3% from 2018 depending on the amount of taxable gross income (upper limit of gross income is GEL 500,000). For a person with a fixed taxpayer status, the rate is fixed, depending on the type of activity and it varies from GEL 1 to GEL 2000 or 3% of income from taxable business. According to the survey, by this legislative change, 93% of entrepreneurs with these statuses have a positive impact on their business by this legislative change, that unequivocally justifies the reform that has been adopted and gives great impetus to entrepreneurs. From positive impact reforms, 13% of entrepreneurs think that introducing special taxation regimes in general and with an additional 13%, consider raising the

upper limit of gross income for entrepreneurs with small business status and lowering the tax rate. Overall, 26% of entrepreneurs think that from positive impact reforms, special taxation regimes are one of the important reforms. It is also noteworthy that most of the entrepreneurs (58%) express income tax reduction initiative based on the present study (which may also be due to the establishment of a pension fund).

Profit tax reform is one of the most extensive reform in recent years. This reform has affected most of business activity and for some categories, the model of profit tax before 2017 remained. Naturally, this reform has many nuances, however, the major difference between these two models is: That the so-called profit tax Estonian model taxpayers are encouraged do not tax reinvested profit. The purpose of this important legislative change is to help entrepreneurs grow their businesses and do not tax the money which will be used for reinvestment. This in turn will help to expand the business, which will also guarantee the creation of new jobs. This reform is meant for the long run. As for the results of the research on this reform, here is an interesting fact, that this reform falls into both positive and negative impact reforms, however, naturally there is a large percentage difference. It should be noted that from reforms having a positive impact, the largest percentage (45%) of entrepreneurs named this reform and from reforms having a negative impact 8% of entrepreneurs rate this reform as negative. whereas 64% of taxpayers of the given model say that reform has a significant positive impact on their business. According to the same survey, only 5% of entrepreneurs want to reduce the profit tax rate. It should be noted that the profit tax rate is one of the most liberal not only in Georgia, but across Europe.

It is also worth noting that one of the areas of tax policy is the liberalization of tax sanctions and in this regard, the Georgian Tax Code has been amended many times and this has affected various types of tax violations. According to the survey, from Positive Impact Reforms 15% of entrepreneurs think that it is precisely the reduction of tax sanctions.

Reforms have also been implemented for entrepreneurs in order to simplify their relationship with the tax authority and their activities. Where various treasury codes were broken down by taxes and since 2016 it has become a UnitedTreasury code. This reform was positively assessed by 12% of entrepreneurs.

In order to simplify the activity for entrepreneurs, reform has taken place, which includes automatic service of refund of overpayments, it came into force in 2016, as for directly in the value added tax (VAT) excess existing cash (for Entrepreneurs), automatic return service (IMF

recommendation) has been in operation since 2019. This reform is very large scale and also important for entrepreneurs. This serves to enable taxpayers to return overpaid funds in a short period of time. Given that, the reform already in place is new and entered into force on 15 February this year, according to the survey, 53% of entrepreneurs did not use the service, 25% of the respondents positively assess the given reform.

The analysis of tax reforms above mentioned and In addition, a survey of entrepreneurs regarding these legislative changes has shown that: Most of the reforms implemented have a positive impact, however, there are also negative impact reforms. While the state should preferably preserve that golden ratio, that the reform should not be to cause a budget deficit, but at the same time it should not impose a huge tax burden on entrepreneurs, which happened in the profit tax and in excise tax case (when adopting the new profit tax model, budget revenues were expected to decline and therefore, to balance the given, the excise tax rate on tobacco products has increased). According to the record of Constitution of Georgia (Article 94), it is not possible to increase tax rate without referendum, excluding Excise tax, therefore, any legislative changes, which causes or may cause a budget deficit, cannot be balanced by the excise tax change alone.

The record in Article 94 of the Constitution of Georgia does not allow the legislature to carry out recommended reforms in tax policy. Because the existing record limits the scope of action. In the light of the existing constitutional record, it can be said as a recommendation that if a specific tax rate is going to reduce and/or may be reduced, it may be balanced by increasing the taxable base for the same tax. It is also natural to take into account the specific share of a given tax in the portion of tax revenues and its impact on the budget. It should be noted, however, that tax rates alone are not the cause of the hindrance for entrepreneurs in their business. The main drawback of the tax system and legislation is ambiguity and instability, since some existing records do not provide an accurate explanation, there are also frequent changes to the tax code during the financial year, this is directly related to tax policy, whose correction/adjustment is possible and desirable.

Based on this research we have developed the following recommendations:

- ✚ In order to implement an optimal tax policy, it is desirable to amend Article 94 of the Constitution so that the introduction of taxes and / or raising existing rates should not require a referendum;
- ✚ If a certain amount of the tax rate is lowered and / or an existing tax benefit model is introduced (e.g. Estonian model of profit tax), It is desirable to balance the expected budget

deficit with the expansion of the existing tax base and not by raising the excise tax rate on certain products. Expanding the tax base can be considered as an optimal solution, because based on the existing constitutional record, it is impossible to balance it with a slight increase in other tax rates (which in some cases is a more optimal solution than expanding the tax base);

- ✚ If the timing of the taxable operation changes, it is advisable to analyze this in the context of the activity. Because in many cases the reform is correct in the context of several activities, but spreading it equally to all entrepreneurs (VAT taxation on advances) is an obstacle for entrepreneurs;
- ✚ For various reasons, most of the entrepreneurs (58%) are under pressure for income tax rate, this may also be due to the establishment of a pension fund. If the tax rate is going to reduce, it must be balanced by increasing the tax base on the same tax;
- ✚ It is desirable to specify ambiguous records in the Tax Code, which does not provide an accurate explanation. That will allow entrepreneurs to act in accordance with the legislation and not to be violated by them unintentionally;
- ✚ Although some measures are being taken to support entrepreneurs, it is desirable to focus more on production and agriculture.
- ✚ The difficulty of obtaining credit resources is the most significant barrier for entrepreneurs in their business, this would require some reform of the business lending service to make it easier for them to obtain financing;
- ✚ Market insecurity from counterfeit and substandard products is also an important barrier for entrepreneurs and it is advisable to tighten the control of substandard products on the market; Also should pay more attention to competition law, because entrepreneurs must be on equal footing;
- ✚ It is very difficult for startups to get into the market, so it is advisable to exempt them from taxation for at least 2-3 years and/or at initial stage taxation of their activities should be at possible lower tax rates;
- ✚ Due to the fact that the agricultural sector in Georgia is not sufficiently developed and is largely imported, it is desirable to impose certain regulations on imported agricultural products, so that Georgian products could compete (because the production of this is much more expensive in Georgia), this in turn will encourage the development of the agricultural sector in Georgia.

Analyzing recent reforms in Georgia is, in most cases, a step forward in supporting entrepreneurs. One of the goals of this reform is to promote small businesses and encourage them with various benefits, part of the reform is aimed at entrepreneurs whose interests include expanding their business and therefore for them the profit tax reform was implemented, according to this, the funds that will be used for reinvestment will not be taxed. Also, United Treasury Codes, where entrepreneurs can easily pay tax. Automatic service of refund of overpayments, which is one of the important and simplified procedures for entrepreneurs. Liberalization of tax sanctions. All of the above legislative changes are important areas of Georgia's tax policy, whose development and promotion is in the interest of the country and therefore these reforms are a major challenge and at the same time encouraging entrepreneurs.

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