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The Tax Treatment of Small and Medium Enterprises in Developed and Developing Countries: A Comparative Analysis of Australia and Egypt

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Many countries design specific tax measures for taxing small and medium enterprises (SMEs) as SMEs play an important role in creating jobs and promoting economic growth. These specific tax rules for SMEs broadly aim to mitigate the overall tax burden including tax liability and tax compliance costs. This article seeks to contribute to the important issue of how such rules for SMEs should be designed in both developed and developing countries through a comparative analysis of the Australian and Egyptian approaches to the issue. In this context, the article first reviews the theoretical literature in relation to taxation of SMEs and international experiences in that field in general. The article then conducts a comparative analysis of the Australian and Egyptian experiences in taxing SMEs and assesses the tax treatment of SMEs in both countries in terms of the tax policy principles of economic efficiency and simplicity, highlighting in particular, two significant new initiatives in Egypt in 2017 and 2020.

The findings reveal that Australia and Egypt have adopted different approaches in providing specific tax treatment to SMEs either within the income tax system or through measures in relation to other taxes. Australia provides specific tax measures for SMEs such as a reduced income tax rate and exemption from capital gains tax and fringe benefits tax. In contrast, Egypt focuses on granting conditional tax exemptions to specific types of SMEs and designing specific measures to simplify tax compliance for SMEs. Both approaches aim to create efficient and simple taxation of SMEs. Nevertheless, simplicity seems to have gained particular attention from policy-makers in both countries. Furthermore, however, Egypt has introduced various measures which deviate from accepted appropriate income tax norms. This may create a significant challenge for any future reform of income taxes in the country and will affect the stability of the overall income tax system. In order to avoid such potential issues, Egypt may learn some lessons from Australia in designing the tax measures that apply to SMEs through balancing the different objectives that a tax system aims to achieve.

1.0 INTRODUCTION

Governments around the world have long sought to encourage small and medium enterprises (SMEs) as an important means to tackle unemployment, increase economic growth and encourage introduction of new products and services to markets. In this context both developed and developing countries have in many cases implemented special policies to stimulate SMEs, which often cover various phases of the SME

growth and start-up development process.¹ One of the special policies very frequently employed involves a tax policy that identifies a specific tax treatment of SMEs, in particular under the income tax, the form of which treatment may vary from one country to another depending on its level of economic development.²

In terms of the costs of taxation for SMEs, the fact that an SME owner commencing a new business will need to comply with income tax regulations implies that the owner bears two types of costs, namely, payment of the legal tax liability and the corresponding tax compliance costs. These burdens may have a negative impact on the development of SMEs, and may encourage the informal business sector.³ In order to minimise these burdens, many governments have accordingly introduced special measures to mitigate the tax liability (for example, granting tax incentives) and/or to simplify tax law and administrative requirements for reducing tax compliance costs. The former type (that is, special tax measures) may be considered as an indirect government subsidy (tax expenditure) that stimulates the creation and growth of SMEs. The preferential tax treatment to SMEs reflects the development role of tax policy, which aims to support SMEs through tax system. This will result in a positive impact on SMEs creation and growth, which in turn spurs private businesses and consequently increases economic growth rates.⁴

In the above context, this article seeks to analyse the design of appropriate SME taxation measures as follows. First, it reviews the theoretical literature on income taxation of SMEs and international experiences in that field, especially start-ups. Secondly, in order to examine the various types of specific tax incentives and practices in detail, it conducts a comparative analysis of the Australian and the Egyptian experiences in taxing SMEs. Thirdly, it assesses the income tax treatment of the SMEs in both of these countries in terms of economic efficiency and simplicity. The scope of the present study is confined to income tax measures and so measures relating to all other taxes are beyond the scope of the discussion.

The rationale for using Australia and Egypt as comparison countries is based on the socioeconomic differences between the two countries. These two countries differ substantially in population size and location, level of economic development, legal system and tax administration. Egypt is the most populous country in the Arab bloc while Australia is a small nation in the Asia Pacific region. In terms of level of economic development, Egypt is currently still a developing country while Australia has long been a developed nation. In terms of legal system, the Australian legal practice is based on common law whereas Egypt is a civil law jurisdiction. Finally, Australia's tax administration is regarded as efficient while that of Egypt is known to suffer from several weaknesses.⁵ By comparing and contrasting two such different countries, we will be able to examine the full range of policy options available to governments in relation to SMEs. Further, there may be lessons that Egypt can learn from Australian experiences, or vice versa.

1 Hansjörg Herr and Zeynep Mualla Nettekoven *The Role of Small and Medium-Sized Enterprises in Development: What Can Be Learned from the German Experience?* (Global Labour University Working Paper No 53, International Labour Organization, Geneva, July 2018) <<https://www.econstor.eu/>>.

2 Colin Mason and Ross Brown "Entrepreneurial Ecosystems and Growth Oriented Entrepreneurship" (paper presented at the *Entrepreneurial Ecosystems and Growth Oriented Entrepreneurship Workshop*, The Hague, Netherlands, 7 November 2013) <<https://www.oecd.org/>>.

3 Eghosa Igudia, Rob Ackrill, Simeon Coleman and Carlyn Dobson "Determinants of the Informal Economy of an Emerging Economy: A Multiple Indicator, Multiple Causes Approach" (2016) 28(2-3) *International Journal of Entrepreneurship and Small Business* 154.

4 IN Dolgih, AB Zhdanova, K A Bannova "The Influence of Taxation on Small Enterprise Development in Russia" (2015) 166, *Procedia – Social and Behavioral Science* 216.

5 As an indirect indicator of a tax administration's effectiveness and efficiency, we can employ the size of the shadow economy as a percentage of gross domestic product (GDP). For Australia, this measure was 8.1 per cent in 2015 and averaged 12.06 per cent over the period 1991–2015. For Egypt, the corresponding figures are 33.32 per cent in 2015 and 36.85 per cent over the same period; see Leandro Medina and Friedrich Schneider *Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?* (International Monetary Fund Working Paper WP/18/17, January 2018) <<https://www.imf.org/en/Publications/>>.

The remainder of this article proceeds as follows. Section 2 briefly sets out the methodology to be employed in the study. Section 3 reviews the academic literature on and international practices in taxing SMEs to prepare the ground for the discussions that follow. We consider the special nature of SMEs and the need for preferential tax treatments of SMEs. Sections 4 and 5 discuss the income tax treatment of SMEs in Australia and Egypt, respectively, while section 6 presents a comparative analysis and assessment of both regimes. Section 7 provides some concluding remarks.

2.0 METHODOLOGY

In order to justify, compare and assess the specific tax treatment for SMEs, this study employs a theoretical analysis research method which is based on economic and legal analysis. Thus, the theoretical analysis will proceed as follows:

- we will review the importance of SMEs to the economy and the challenges facing them which justify specific tax treatment;
- we will compare practices of one developed country (Australia) with one developing country (Egypt) to identify various tax measures that have been implemented to provide specific tax treatment to SMEs and how the tax treatment varies from developed to developing countries;
- in the context where the main objective of specific tax treatment for SMEs is to mitigate the overall tax burden, including the legal tax liability and the tax compliance costs, the study will use two of the key criteria for a “good tax system” of economic efficiency and simplicity to assess the specific tax measures for SMEs in the two countries (from the overall set of such criteria, of economic efficiency, equity, simplicity and stability).⁶ Economic efficiency is concerned with minimising distortions and simplicity with minimising tax operating costs (in particular, tax compliance costs to SME taxpayers).

Based on the theoretical analysis, we deduce specific inferences with regard to the appropriate tax treatment for SMEs in developed and developing countries and then provide some specific policy recommendations.

3.0 REVIEW OF LITERATURE AND INTERNATIONAL PRACTICES

3.1 Definitions of SMEs

Defining what constitutes an SME is of more than mere academic interest because such definitions typically provide the identification of the eligibility criteria for preferential tax measures. Many countries have introduced specific definitions of SMEs, which are based on either quantitative or qualitative measures or a combination of both.⁷ The quantitative measures include, for example, number of employees, turnover, sales volume, and capital assets, etc, while qualitative measures are based on particular criteria, such as the legal form of the business (unincorporated vs incorporated).⁸ This definition helps to determine the taxpayers who will be eligible as SMEs for the preferential tax measures through criteria that may be provided by either the tax law or other laws. Bergner and co-authors have discussed classification of businesses in terms of their size in the context of the European Union (EU), where the classification is composed of four

6 Joseph T Sneed “The Criteria of Federal Income Tax Policy” (1965) 17(4) *Stanford Law Review* 567.

7 Sören Martin Bergner, Rainer Bräutigam, Maria Theresia Evers and Christoph Spengel *The Use of SME Tax Incentives in the European Union* (Centre for European Economic Research Discussion Paper No 17-006, January 2017) <<http://ftp.zew.de/>>.

8 William Gale and Samuel Brown “Small Business, Innovation, and Tax Policy: A Review” (2013) 66(4) *National Tax Journal* 871.

categories, namely, micro, small, medium and large.⁹ The EU's classification benchmark may, however, differ from the definition of an SME in each particular member country of the EU for tax purposes.

3.2 Role of SMEs in the Economy

SMEs represent around 99 per cent of firms in the Organisation for Economic Co-operation and Development (OECD) member countries and more than 95 per cent of businesses in developing countries.¹⁰ A recent report for the European Commission indicates that SMEs are responsible for 67 per cent of total employment and 57 per cent of gross domestic product (GDP) of European countries, as against 33 per cent and 43 per cent respectively for large firms.¹¹ These figures firmly demonstrate the importance of SMEs to the economy from a macroeconomic perspective.

Many researchers have further examined the contributions of SMEs to the economy. For example, Gherghina and co-authors have highlighted the importance of SMEs to national economies,¹² noting that SMEs and entrepreneurship represent key factors for job creation, introduction of new products and services, and economic growth. Consequently, Thurik and Wennekers have emphasised the need for governments around the world to develop special policies to encourage entrepreneurship, innovation and small business.¹³ Furthermore, Akinyemi and Adejumo have examined the impotence of government policies in African countries to stimulate innovation and entrepreneurship.¹⁴ The fact that the bulk of new established businesses are small and medium enterprises also implies that SMEs play an important role in mitigating unemployment rates through creating new jobs and contributing to economic growth.¹⁵

Many scholars have examined the importance of specific tax policies and legislation for SMEs. For example, in an albeit now dated study, Keith reviewed the tax treatment of small business in the US in the aftermath of the Second World War as he noticed a significant increase in the number of such businesses resulting in high employment rates accordingly.¹⁶ In 2015 the OECD published a study about the tax incentives to SMEs indicating that many countries provide tax incentives or have specific tax regimes for SMEs.¹⁷

3.3 Problems Facing SMEs

As private firms, SMEs face several difficulties. Number of researchers indicate that the challenges face SMEs are often similar in developed and developing countries. For example, Yoshino and Taghizadeh-Hesary investigate the challenges that SMEs facing in Asian developed countries (for example, Japan and South

9 Bergner, Bräutigam, Evers and Spengel, above n 7.

10 OECD *Taxation of SMEs in OECD and G20 Countries* (OECD Tax Policy Studies No 23, OECD, Paris, 2015) <<https://www.oecd-ilibrary.org/>>.

11 Patrice Muller, Jenna Julius, Daniel Herr, Laura Koch, Viktoriya Peycheva and Sean McKiernan *Annual Report on European SMEs 2016/2017: Focus on Self-Employment* (European Commission, 2017) <<https://publications.europa.eu/>>.

12 Ștefan Cristian Gherghina, Mihai Alexandru Botezatu, Alexandra Hosszu and Liliana Nicoleta Simionescu "Small and Medium-Sized Enterprises (SMEs): The Engine of Economic Growth through Investments and Innovation" (2020) 12(1) *Sustainability* 1.

13 Roy Thurik and Sander Wennekers "Entrepreneurship, Small Business and Economic Growth" (2004) 11(1) *Journal of Small Business and Enterprise Development* 140.

14 Folashade O Akinyemi and Oluwabanmi O Adejumo "Government Policies and Entrepreneurship Phases in Emerging Economies: Nigeria and South Africa" (2018) 8 *Journal of Global Entrepreneurship Research*, Article 35.

15 Elizabeth J Gatewood and Sylvain Boko "Globalization: Entrepreneurial Challenges and Opportunities in the Developing World", in Anders Lundström (ed) *The Role of SMEs and Entrepreneurship in a Globalised Economy* (Expert Report No 34 to Sweden's Globalisation Council, Stockholm, 2009) at 121 <www.government.se/>.

16 E Gordon Keith "The Impact of Taxation on Small Business" (1959) 24(1) *Law and Contemporary Problems* 98.

17 OECD, *Taxation of SMEs in OECD and G20 Countries*, above n 10.

Korea) and developing countries (China and India).¹⁸ They find a number of common challenges which include (a) access to finance, (b) economies of scale and (c) high risk of failure in early years.

First, the inherent risks that accompany SMEs create a difficulty in access to finance through debt mechanisms (for example, bank finance).¹⁹ Thus, the bulk of SME finance is equity finance, which may be considered as an example of market imperfection.²⁰ Conversely, large businesses can access funds more easily through loan mechanisms, because of their ability to provide sufficient collateral and as they have historical accounting records. Accordingly, SMEs are disadvantaged because of their reliance on equity finance considering that implicit costs are generally not deductible for income tax purposes, while large businesses can deduct debt interest from taxable income, which minimises their tax burden. Therefore, providing preferential tax treatments to SMEs is an important tool to tackle this market imperfection issue.²¹

Secondly, because of their size, it is often difficult for SMEs to achieve economies of scale in their operations, which implies that they produce at higher average costs compared with large corporations.²² This results in SMEs not being able to compete with large businesses, especially in terms of price. Such a situation justifies granting preferential tax treatments to SMEs. Correcting this issue is also justified because of positive externalities derived from stimulating SMEs.²³

Thirdly, SMEs and start-up entrepreneurs face several challenges in their early years, which tends to make their success rate and sustainability very low.²⁴ Thus, mitigating the tax burden on SMEs in their early years can contribute to their success and sustainability and consequently minimise the possibility of failure.²⁵

Thus, while SMEs in developed and developing countries are operating in different contexts, including legal/taxation, we can extrapolate these common themes in terms of the common problems SMEs face. However, as discussed below, the specific tools employed for mitigating these common problems may differ from country to country.

3.4 Preferential Tax Treatments of SMEs

The abovementioned literature regarding the contributions of SMEs to the economy, market imperfection and positive market externalities of SMEs provides a theoretical justification of government support for SMEs. There are nevertheless many opponents of preferential tax treatment for SMEs. Those tax researchers call for neutral tax treatments to business activities. For example, Chen, Lee and Mintz have provided a number of reasons why SMEs should be treated in a similar way to other businesses regardless

18 Naoyuki Yoshino and Farhad Taghizadeh “Major Challenges Facing Small and Medium-sized Enterprises in Asia and Solutions for Mitigating Them” (2016) (Asian Development Bank Institute, Working Paper Series No 564, April 2016). <www.adb.org/publications/>.

19 Hezron Mogaka Osano and Hilario Languitane “Factors Influencing Access to Finance by SMEs in Mozambique: Case of SMEs in Maputo Central Business District” (2016) 5 *Journal of Innovation and Entrepreneurship*, Article 13.

20 Douglas Holtz-Eakin “Should Small Businesses Be Tax-Favored?” (1995) 48(3) *National Tax Journal* 387 at 391.

21 Gale and Brown, above n 8, at 883–884.

22 Ayansola Olatunji Ayandibu and Jennifer Houghton “The Role of Small and Medium Scale Enterprise in Local Economic Development” (2017) 11(2) *Journal of Business and Retail Management Research* 133.

23 Burçin Bozdoğanoglu “Factors That Effect Taxation of Small and Medium Sized Enterprises (SMEs)” (2016) 4(2) *International Journal of Humanities and Management Sciences* 176 at 178.

24 S Ngcobo and R Sukdeo “Challenges Facing SMMs During Their First Two Years of Operation in South Africa” (2015) 12(3) *Corporate Ownership and Control* 505.

25 Saša Petković, Clemens Jäger and Boban Sašić “Challenges of Small and Medium Sized Companies at Early Stage of Development: Insights from Bosnia and Herzegovina” (2016) 21(2) *Management* 45.

of their size.²⁶ These reasons are: (1) preferences give rise to a threshold effect as SME owners will prefer to stay small in order to maintain the favourable tax treatment and, in this way, SMEs will not be keen to grow beyond the eligibility threshold, so hindering the growth of SMEs and their sustainability; (2) in a similar way, preferences may give rise to a breakup effect, where in order to be eligible for tax incentives provided to SMEs, some large businesses will prefer to break up into several smaller businesses; and (3) because of tax incentives, a tax system will not be neutral, which affects investors' decisions and results in economic distortions relating to choices among various legal forms of business, including whether to adopt an incorporated or unincorporated form, as the majority of SMEs are unincorporated businesses. Nevertheless, the authors of that study did propose providing preferential tax treatment to capital gains derived by small businesses as a tool to encourage SMEs to grow and expand.²⁷

In practice, the EU has designed a policy for SMEs, which has resulted in introduction of the Small Business Act, which aims to provide guiding principles for EU governments to develop SME policies.²⁸ These guiding principles include creating an environment favourable to growth of entrepreneurial and family businesses and in which entrepreneurship is rewarded; adapting elements of public policy, such as procurement and state aid rules, to SME needs; and facilitating SMEs' access to finance, and developing payment systems in which SMEs can effectively participate.²⁹ Based on the European Small Business Act, the OECD has developed an index to assess each country's practices related to SME policies.³⁰

Among the government policies that have a significant impact on SMEs is tax policy and related tax legislation. In this context, the academic literature seeks to answer the following two questions:

- What are the criteria for granting such preferential tax measures?
- What are the tools for granting preferential measures for SMEs?

The remainder of this section addresses each of the above questions in turn.

First, as mentioned previously, identifying the eligibility criteria for preferential tax measures starts by defining what constitutes an SME. In terms of the definition of SMEs for preferential tax treatment purposes, researchers tend to distinguish between self-employed individuals and legal entities. Gale and Brown examined the definition of SMEs from the US tax perspective and classified them into unincorporated and incorporated legal entities.³¹ The former include sole proprietorship businesses and partnerships, while the latter include limited liability companies and C corporations. The tax legislation seeks to mitigate the tax burden on SME owners regardless of the legal form of their businesses.³² This type of tax treatment fits with the special nature of SMEs, as the bulk of these businesses are owned by self-employed taxpayers. In this context, the key issue often relates to how to determine the SMEs' taxable income, as either assessed by tax authorities or returned in accordance with the provisions of the tax law. In a similar way, Crawford and Freedman examined the definition of SMEs for tax purposes in the United Kingdom, which is based on

26 Duanjie Chen, Franck Lee and Jack M Mintz *Taxation, SMEs and Entrepreneurship* (OECD Science, Technology and Industry Working Paper 2002/9, 9 August 2002) <www.oecd-ilibrary.org/>.

27 Chen, Lee and Mintz, above n 26.

28 Commission of the European Communities, “‘Think Small First’, A ‘Small Business Act’ for Europe”, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, COM(2008)394 final, 25 June 2008 <<https://eur-lex.europa.eu/>>.

29 David B Audretsch and A Roy Thurik “Globalization, ‘Entrepreneurship and the Strategic Management of Regions’” in Lundström, above n 15.

30 OECD *SMEs, Entrepreneurship and Innovation* OECD Studies on SMEs and Entrepreneurship (OECD Publishing, Paris, 2010).

31 Gale and Brown, above n 8.

32 Gale and Brown, above n 8.

qualitative criteria. They explained that different tax treatments are afforded to the SME depending upon whether they involve a self-employed individual (sole proprietorship or partnership) or owner-manager of a company.³³

A complicating issue also emerging from the academic literature is the desirability of targeting SME taxpayers for tax preferential treatments. In his seminal study referred to previously, Keith stated that the bulk of SMEs were routine businesses that did not deserve preferential tax treatment, while the remainder of SMEs were non-routine businesses involved in introducing new products or services that did deserve the granting of special tax treatment.³⁴ In summary, each country provides specific criteria for defining SMEs, which determines the scope of implementation and eligibility of taxpayers to preferential tax measures for SMEs.

Secondly, the preferential tax measures for SMEs are often granted within both the income tax and value added tax (VAT) laws. Nevertheless, we focus here only on the income tax measures as are briefly discussed below.

3.5 Income Tax Measures for SMEs

In a number of situations, the provisions of income tax legislation may deviate from established tax norms to achieve various socio-economic objectives.³⁵ This can include the granting of preferential tax treatments to the owners of SMEs, whether they are unincorporated or incorporated taxpayers, and which may be limited to SMEs in specific industries or business activities. Many developed and developing countries use different measures to grant preferential tax treatment to SMEs under income tax, such as: (1) reduced tax rate on an SME's taxable income; (2) specific deductions and allowances from an SME's taxable income; (3) tax incentives to SMEs for research and development (R&D) activities; (4) tax credits; (5) tax exemption for SMEs' capital gains, and (vi) absolute tax exemption.³⁶ These are common incentives, which often vary from one country to another.

In the United States, the Internal Revenue Code provides several tax incentives which target SMEs and entrepreneurial activities. Gale and Brown noted various tax incentives for SMEs, which include for example: (1) exemption from the corporate minimum tax according to the Taxpayer Relief Act of 1997, which is based on business size and is granted for a limited period (three years from commencing business activity); (2) amortisation of business start-up costs in accordance with s 195 of the Internal Revenue Code, and (3) tax incentives for private equity investment in small business.

Bergner and co-authors have listed various types of tax incentives for SMEs and entrepreneurs in Europe.³⁷ For example, several countries, such as France, Hungary, Portugal and Spain, implement reduced tax rates on SMEs' income. Other incentives, such as accelerated depreciation for capital assets, are used by Germany and Poland. A further group of countries provide tax credits, special deductions and allowances including tax incentives to R&D expenditures of SMEs, such as Malta, the Netherlands and Spain.

33 Claire Crawford and Judith Freedman "Small Business Taxation" in Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James M Poterba (eds) for the Institute for Fiscal Studies *Dimensions of Tax Design: The Mirrlees Review, Vol 1* (Oxford University Press, Oxford, 2010) at 1028.

34 Keith, above n 16.

35 Eric M Zolt "Tax Incentives: Protecting the Tax Base" (paper for the *United Nations Workshop on Tax Incentives and Base Protection*, New York, 23-24 April 2015) <www.un.org/>.

36 Bozdoğanoglu, above n 23, at 178.

37 Bergner, Bräutigam, Evers and Spengel, above n 7.

Summing up, tax incentives for SMEs under the income tax can be classified into output tax incentives and input tax incentives. The former includes reduced tax rates applicable to taxable income of SMEs and entrepreneurs, which result in reduced tax liability for SMEs and entrepreneurs. The latter include special deductions and allowances from taxable income, which result in a reduced tax base and consequently reduction of the income tax burden of SMEs.

4.0 TAXING SMALL AND MEDIUM ENTERPRISES IN AUSTRALIA

4.1 Definitions of SMEs

Australia employs a flexible approach with no unique or official definition that applies in all cases. Australia's approach consists of two types of definition, one for statistical purposes (that is, for counting the number of businesses by size) and one for statutory rules. For statistical purposes, there are two main approaches. The Australian Bureau of Statistics (ABS) defines business size in terms of number of employees³⁸ whereas the Australian Taxation Office (ATO) classifies business size by reference to annual turnover.³⁹ Statutory definitions only distinguish between small and non-small businesses, and the criteria vary from one legislative enactment to another.⁴⁰ For example, a small business is defined alternatively in the following terms, namely as a business:

- that employs less than 15 employees for the purpose of unfair dismissal provisions (Fair Work Act 2009, s 23);
- that employs less than 20 employees and the upfront price payable under a contract with the business does not exceed AUD 300,000 (or AUD 1,000,000 if the contract has a duration of more than 12 months) for protection against unfair contracts (Competition and Consumer Act 2010, Sched 2, s 23).

Table 1 summarises the ABS and ATO definitions of SMEs in Australia. While these definitions differ, there tends to be a strong positive correlation between them.

38 Australian Bureau of Statistics (ABS) "Glossary" *Australian Industry, 2008–09, Cat 8155.0* (Canberra, 2010) <www.abs.gov.au/>.

39 Australian Taxation Office (ATO) "Eligibility – Small Business Entity Concessions" (last modified 10 December 2020) <www.ato.gov.au/>. While the ATO's definition of a small business is essentially the same as that specified in the Income Tax Assessment Act 1997 (Cth), s 328-110, there are no definitions of medium-sized and large businesses in the same Act. Thus, the ATO's classification of business size by turnover can only be considered for statistical purposes.

40 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hon Kenneth Hayne, chair) *Financial Services and Small and Medium-Sized Enterprises (SMEs)* (Background Paper 12, Canberra, 2018) at 5–6.

Table 1: Definitions of SMEs, Australia

Authority	Criterion	Classification	
ABS	Number of employees	0 employees	self-employed
		1–4 employees	micro
		5–19 employees	small
		20–199 employees	medium
ATO	Annual turnover	Less than A\$10 mil	small
		Between A\$10 mil and A\$250 mil	medium

Sources: Australian Small Business and Family Enterprise Ombudsman⁴¹ and ATO.⁴²

It is evident that the SME definition for tax purposes is based on a single and measurable criterion that is the annual turnover of the business.⁴³

4.1.1 Special Income Tax Measures for SMEs

A simplified tax system (STS) was introduced in Australia, with effect from 1 July 1999, in order to mitigate the impact of the tax system on small business. It introduced specific measures for SMEs in four areas, namely: (1) use of cash accounting; (2) tax treatment of advance payments; (3) depreciation of capital assets, and (4) treatment of trading stock.⁴⁴ Small businesses needed to meet two conditions in order to implement STS rules, which were: (1) business entities should carry on an active business in the taxable year, and (2) have an annual turnover of up to AUD 1 million. While SMEs could opt to use STS if they met the preceding criteria, business entities were required to implement the four elements of the regime. A number of authors, such as Kenny⁴⁵ and Marsden, Sadiq and Wilkins⁴⁶ criticised the STS. For example, Kenny identified that the eligibility criteria were complicated in terms of three areas, namely: (1) the determination of business turnover, which hindered business accessing the benefits of the STS; (2) rules for leaving the system, as business could only apply to re-enter STS five or more years after leaving it, and (3) the requirement for compulsory implementation of the four items of the STS.⁴⁷ In addition, there were as a result different measures for taxing SMEs under income tax, goods and services tax (GST) and fringe benefits tax (FBT).⁴⁸ This kind of complexity led to reform of the STS through the introduction of a new tax system called the small business entities (SBE) rules.

41 Australian Small Business and Family Enterprise Ombudsman *Small Business Counts: Small Business in the Australian Economy* (Commonwealth of Australia, Canberra, 2016) at 8.

42 ATO “Eligibility – Small Business Entity Concessions”, above n 37 and ATO “Large Business” (last modified 25 November 2020) <www.ato.gov.au/>.

43 In March 2019, the Board of Taxation issued a report on its review of small business tax concessions: Board of Taxation *Review of Small Business Tax Concessions: A Report to the Treasurer* (March 2019) <<https://taxboard.gov.au/sites/>>.

44 Paul Kenny “Tax Accounting Concessions for Small Business Entities: One Small Step for Small Business” (2008) 3(2) *Journal of the Australasian Tax Teachers Association* 226.

45 Kenny, above n 44.

46 Stephen Marsden, Kerrie Sadiq and Timothy Wilkins “Small Business Entity Tax Concessions: Through the Eyes of the Practitioner” (2013) 22(1) *Revenue Law Journal*, Article 4.

47 Marsden, Sadiq and Wilkins, above n 46.

48 FBT is a tax imposed on fringe benefits provided by employers to their employees in accordance with the Fringe Benefits Tax Assessment Act 1986 (Cth). SMEs with annual turnover of less than AUD 10 million are exempt from FBT on specific benefits, such as car parking and electronic devices. For further information, see ATO “FBT Concessions” (last modified 10 December 2020) <www.ato.gov.au/>.

Accordingly, SMEs that constitute eligible SBEs in Australia are now granted a small number of concessions within the Income Tax Assessment Act 1997 (Cth) (ITAA 1997). The SBE regime is intended to provide a uniform definition for SMEs through setting a standard turnover that is implemented across the income tax, GST and FBT systems. The ITAA 1997 and related regulations provide a number of tax concessions covering income tax, FBT and capital gains tax (CGT). In this context, subdiv 328-C of the ITAA 1997 defines a small business entity in the following terms:

You are a *small business entity* for an income year (the *current year*) if:

- (a) you carry on a business in the current year; and
- (b) one or both of the following applies: (i) you carried on a business in the income year (the *previous year*) before the current year and your aggregated turnover for the previous year was less than \$10 million; (ii) your aggregated turnover for the current year is likely to be less than \$10 million.

This definition uses turnover as a key factor for determining eligibility for small business concessions, which differs from the definition of SMEs used in other contexts by the Australian government as previously explained. These concessions include the following:

- a reduced tax rate at 26 per cent for an incorporated small business (compared to the standard company tax rate of 30 per cent) which will be further reduced to 25 per cent from 1 July 2021, and a corresponding small business tax offset of up to AUD 1,000 for a small business which may be a sole proprietorship, a partnership or trust and with annual turnover in these cases of less than AUD 5 million.
- exemption from FBT,⁴⁹ and
- a special concession for capital gains derived from disposition of SME capital assets within a specific period.

These tax concessions aim to minimise the overall tax burden on SMEs in order to encourage them to scale up and compete with other similar businesses.

4.2 Reviewing Small Business Tax Concessions

In March 2019, the Board of Taxation issued a report from its review of the small business tax concessions.⁵⁰ The aim of this review was to assess small business tax concessions in accordance with three tax principles, efficiency, simplicity and equity, in order to make small business tax concessions more effective and less costly to the government. The report comprised nine chapters that provide a comprehensive review of small business tax concessions, in which each chapter gives specific policy recommendations. The overall recommendations covered three aspects for granting tax concessions, including the small business definition, tax concessions and the way to address simplicity of tax treatment.

The report recommended harmonising the small business definition for tax purposes, as there are three thresholds for annual turnover, which are used for granting tax incentives for SMEs. The harmonisation of small business definition would help to avoid complexity and make it more transparent for small business owners. For the tax concessions, the third recommendation stated the importance of repealing the simplified trading stock rule. It was mentioned that the objective of this rule is to simplify compliance for measuring the value of trading stock. However, it seems that the rules do not have significant impact

⁴⁹ See above, n 48.

⁵⁰ Board of Taxation, above n 43.

on small business.⁵¹ With regard to CGT, the fourth recommendation called for a simpler, fairer and more sustainable CGT concession, in order to encourage growth of SMEs. For the effectiveness of tax incentives, the sixth recommendation called for replacement of the unincorporated small business tax discount with alternative program.⁵²

The Board of Taxation report highlights the importance of a frequent assessment of tax incentives in general and of those to small business, in particular, to ensure their effectiveness for achieving their goals on the light of the principles of good tax system. It is also important to ensure the dynamics of tax system align with socio-economic changes.

5.0 TAXING SMALL AND MEDIUM ENTERPRISES IN EGYPT

5.1 Definitions of SMEs

Egypt has adopted a more prescriptive approach compared with the Australian rules in defining SMEs based primarily on paid-in capital. Ministerial Decrees 414 of 2009 and 54 of 2012 specify the definition of small enterprises to be “any enterprise with a paid-in capital of not more than EGP 1 million and a number of employees of not more than 50”. These enterprises are further classified into three categories (A, B and C) in accordance with Article 3 of Decree No 54. According to Article 3, for tax purposes, a small business can be defined based on one of the following indicators, namely paid-in capital, annual turnover and assessed tax liability, where the tax liability indicator takes precedence over turnover and turnover takes precedence over paid-in capital. Table 2 summarises the definitions of the three categories of small businesses in terms of the classification criteria in Egypt.

Table 2: Classification of Small Enterprises, Egypt

Category	Paid in Capital	Turnover	Assessed Tax Liability
A	≤ EGP 50,000*	≤ EGP 250,000	≤ EGP 20,000
B	> EGP 50,000 and ≤ EGP 250,000	> EGP 250,000 and ≤ 1,000,000 EGP	> EGP20,000 and ≤ EGP 100,000
C	EGP 250,000 and EGP 1,000,000	> EGP 1,000,000	> EGP 100,000

Source: Ministerial Decree No 54 of 2012. The exchange rate of 1 EGY= AUD 0.085

Table 2 indicates that the three categories of businesses, A, B and C, represent micro, small and medium businesses, respectively. It is worthwhile to note that the definitions of different types of small businesses in Egypt in terms of monetary currency (EGP) do not provide for automatic indexation of the amounts. Given the relatively high annual inflation rate in Egypt, this implies that the current threshold definitions would need to be revised upward from time to time.⁵³

51 Board of Taxation, above n 43, at 18, 30.

52 Board of Taxation, above n 43, at 26–27.

53 Heba Youssef Mohammed Hashem “Inflation in Egypt: A Fiscal or Monetary Phenomenon?” (2017) 13(4) *Business and Economic Horizons* 522.

5.2 Income Tax Measures

In 2005, a new tax policy was introduced focusing on reducing tax rates and broadening the tax base. This supply side tax policy resulted in the ratification of Income Tax Law No 91 of 2005 (ITL 2005).⁵⁴ The new legislation allows the tax authority to introduce specific measures for taxing SMEs.⁵⁵ Article 18 of the ITL 2005 states that SMEs are subject to specific tax measures for working out their tax base. This provision states that “special tax measures will be issued by the Minister of Finance for measuring the tax base of SMEs considering that these measures do not conflict with SMEs Law No 141 of 2004 in order to support them”.⁵⁶ The Minister of Finance has issued a number of decrees for the implementation of this provision. For example, as noted above, Ministerial Decrees 414 of 2009 and 54 of 2012 specify the definition of small enterprises to be “any enterprise with a paid-in capital of not more than EGP 1 million and a number of employees of not more than 50”, as classified into the three categories (A, B and C) in accordance with Art 3 of the aforementioned Decree No 54.

On the other hand, SMEs funded by the Social Development Fund (SDF) are eligible to conditional tax exemption according to Art 31 of the ITL 2005.⁵⁷ These enterprises enjoy tax exemption of up to 50 per cent of their taxable income, if they satisfy two conditions: (1) the percentage of the loan to invested capital of the incumbent business is up to 50 per cent, and (2) the exemption amount does not exceed EGP 50,000 annually. In order to implement this provision, Art 42 of the Executive Regulations states four further conditions for tax exemption. These are: (1) the date of obtaining the loan from the SDF is prior to the date of starting business; (2) the enterprise takes the legal form of a sole proprietorship; (3) the enterprise is involved either in commercial or industrial activity only, and (4) the enterprise maintains regular accounting books.

By contrast, new Investment Law No 72 of 2017 considers SMEs and entrepreneurship as an investment area, into which investors may invest in accordance with item (2) of Article 2. The item provides that “the State shall support start-ups and boost entrepreneurship, micro, small and medium enterprises to empower the youth and small investors”.⁵⁸ Thus, SMEs and entrepreneurial activities are eligible to the incentives and guarantees provided in that law. SMEs and entrepreneurship enjoy tax incentives, which includes the entitlement to deduct 30 per cent of their investment costs from taxable income for up to seven years from starting business. In this context, Art 11 of the Executive Regulations of the law states that “the investment cost of the project” means the costs required to establish the investment project.⁵⁹ They include the equity rights plus the long-term liabilities which are invested in the establishment or construction of the fixed assets (tangible) and non-material assets (intangible) in the project provided they are paid in cash, and the working capital.

5.3 Taxing SMEs under New SMEs Law No 152 of 2020

A further new SMEs Law No 152 of 2020 was issued on 15 July 2020, introducing specific provisions to deal with various phases for establishing micro, small and medium businesses (MSMEs) in Egypt. The law includes tax and non-tax incentives and sets out a specific tax treatment for SMEs. An overview is briefly

54 Mahmoud M Abdellatif Khalil and Binh Tran-Nam “The Tax Policy Debate Regarding Tax Incentives in Developing Countries: The Case of Targeted Tax Incentives in Egypt” (2016) 70(7) *Bulletin for International Taxation* 379.

55 Abdellatif and Tran-Nam, above n 54.

56 Egypt, Income Tax Law No 91 of 2005.

57 The Social Development Fund was the government agency in charge of SMEs in Egypt. Recently it was replaced by the SMEs Promotion Agency, which was established by Prime Minister’s Decree No 947 of 2017.

58 For further details, see Article 2 of Investment Law No 72 of 2017.

59 The Executive Regulation of Investment Law, issued by Prime Minister’s Decree No 2310 of 2017.

set out below about that law that may shed light on the SMEs' definition, tax incentives and tax treatment that may assist the comparative analysis of this study.

5.3.1 Definition of SMEs

Article No 1 of the law sets out a number of definitions including the definitions of medium, small and micro enterprises. These definitions employ two criteria for classifying businesses, which are paid-in capital or annual turnover. Further, the application of these criteria is different for industrial activities. Table 3 summarises the three definitions.

Table 3: Classifications of Micro, Small and Medium Enterprises

Business Size	Business Types	Paid-in capital	Annual Turnover
Micro	Non-Industrial	less than EGP 50,000	Less than EGP 1,000,000
	Industrial		
Small	Non-Industrial	EGP 50,000 – less than 3,000,000	EGP 1,000,000 – 50,000,000
	Industrial	EGP 50,000 – less than 5,000,000	
Medium	Non-Industrial	EGP 3,000,000 – 5,000,000	EGP 50,000,000 – 200,000,000
	Industrial	EGP 5,000,000 – 15,000,000	

Table 3 shows that the size of each business is based on the amount of its paid-in capital or annual turnover.

5.3.2 Tax incentives

The rationale of the new small business law is to encourage establishment of new businesses and to support the growth of existing ones to create more jobs and increase economic growth. Accordingly, the law provides several tax incentives that are available to SMEs. These incentives include:

- exemption from stamp duties, business registrations fees, and contracts registration fees for informal businesses, when they start registration as formal businesses in accordance with Art 27.
- imported items of plant and machinery of SMEs are subject to 2 per cent customs duties in accordance with Art 28; and
- exemption of capital gains derived from the sale of capital assets when the sale proceeds are used for acquiring new capital assets according to Art 29; and
- tax exemption for dividends of a sole person company according to Art 31.

The above tax incentives thus cover stamp duties, customs duties, capital gains and dividends. However, there are no income tax incentives because the law introduced separate simplified measures for taxing the income of MSMEs, as will be elaborated below.

5.3.3 Special tax measures for MSMEs

The above new Law No 152 of 2020 introduces new measures for taxing MSMEs, in an approach which deviates from current Income Tax Law No 91 of 2005. These new measures include two types of taxes

replacing existing income tax measures. These taxes are a lump sum tax on micro businesses and turnover taxes on small and medium enterprises.

In this context, a micro business annually pays a flat tax at an amount which depends on their annual turnover.⁶⁰ Therefore, Art 94 of the new law states that:

- if the annual turnover of the business is less than EGP 250,000, it pays an annual lump sum amount of EGP 1,000,
- if the annual turnover of the business is EGP 250,000 or more but less than EGP 500,000, it pays an annual lump sum amount of EGP 2,500, and
- if the annual turnover of the business is EGP 500,000 or more but less than EGP 1,000,000, it pays an annual lump sum amount of EGP 5,000.

On the other hand, Art No 93 imposes a kind of turnover tax on SMEs with higher annual turnover amounts as follows:

- if the annual turnover of the business is EGP 1,000,000 or more but less than EGP 2,000,000, it pays a flat rate tax at 0.5 per cent of its annual turnover,
- if the annual turnover of the business is EGP 2,000,000 or more but less than EGP 3,000,000, it pays a flat rate tax at 0.75 per cent of its annual turnover, and
- if the annual turnover of the business is EGP 3,000,000 or more but less than EGP 10,000,000, it pays a flat rate tax at 1.0 per cent of its annual turnover.

The SMEs pay turnover tax for five consecutive years. The annual turnover is determined in each of these years in accordance with one of the following criteria:

- amount of income tax as assessed by the Egyptian tax authority in previous years,
- the amount of income tax from any tax assessment received according to the first tax return that business files to the tax authority, or
- the amount of income according to the first tax return that a new business files to the tax authority.

The tax authority has the right to review the reported annual turnover once every five years through a tax audit of the SME.

6.0 COMPARISON AND DISCUSSION

6.1 Definitional Issue

There are often many definitions of SMEs to serve various policy objectives. This has been reflected in the definitions of SMEs adopted in both Australia and Egypt. Nevertheless, providing a transparent and simple definition of SMEs for tax purposes is considered as the key factor for the successful implementation of preferential tax treatments of SMEs.⁶¹

60 OECD *Regulatory Policy in Croatia: Implementation is Key*, OECD Reviews of Regulatory Reform (OECD Publishing, Paris, 2019) <<https://doi.org/10.1787/b1c44413-en>>.

61 Gale and Brown, above n 8.

The review of SME tax concessions conducted by the Board of Taxation in Australia recommended harmonising the definition of SMEs for tax purposes as there are three different thresholds for annual turnover in order to determine business eligibility to various SME tax concessions, namely: (1) the common annual turnover threshold of AUD 10 million for the bulk of tax concessions; (2) the second annual turnover threshold of less than AUD 5 million that is the eligibility criterion for the unincorporated small business tax discount, and (3) the third annual turnover threshold of less than AUD 2.0 million that is the eligibility criterion for the CGT concession. It may be advisable for the ATO to have a unified turnover threshold of less than AUD 10.0 million annually for all of the various types of tax concessions in order to simplify tax compliance and avoid any possible complexity. Nevertheless, the tax definition of SMEs is at least based on a single criterion of turnover, which is measured through identifying what is included in aggregate annual turnover and what is excluded from it.⁶²

There are many definitions of SMEs for tax purposes in Egypt, which are provided either through the tax or non-tax regulations. The Ministerial Decrees 414 of 2009 and 54 of 2012 have specific definitions of SMEs. In addition, the new SMEs Law of 2020 provides another definition of SMEs. Nevertheless, the Investment Law No 72 of 2017 does not have any definition for SMEs despite providing tax incentives to them under Art 11. The definitions of SMEs for tax purposes are also based on a variety of criteria, including paid-in capital, annual turnover and assessed tax liability.

Based on the above analysis of the definitions of SMEs under the Australian and Egyptian tax systems, we can make the following observations:

- both countries have specific definitions of SMEs for tax purposes, but the Australian (tax) definition is at least based on a single criterion (annual turnover), while the Egyptian (tax) definition is based on multiple criteria, which makes it difficult for taxpayers to comply with the provisions and tax administrators to enforce them;
- in both Egypt and Australia, definitions of SMEs are provided under both tax and non-tax regulations;
- the Australian definition provides tax incentives to various types of SMEs as long as they meet the threshold criterion while the Egyptian definitions are designed to serve specific type of business entities in accordance with their establishing law. For example, the definition under new SMEs Law of 2020 requires registration of SMEs with the SMEs agency.

6.2 Assessing Taxation of SMEs in Terms of Economic Efficiency

It is known that taxation creates distortions, which reduce economic efficiency. However, where there is a market failure, which may be related to either negative or positive externalities, taxation can play an important role to correct such market failure. Appropriate tax measures in this case can involve Pigouvian taxes and subsidies.⁶³ Subsidies are granted to promote positive externalities as the market mechanism leads to an under-supply of them. In the context of the present study, SMEs and entrepreneurship face market failure and imperfection as was explained in s 3. As a result of these issues, investors may be reluctant to start small businesses, despite their importance in both macroeconomic and microeconomic terms, especially their positive spillovers generated for the economy. Accordingly, many governments indirectly subsidise SMEs through granting specific tax treatments.

⁶² Board of Taxation, above n 43, at 17.

⁶³ Alan Randall “The Problem of Market Failure” (1983) 23(1) *Natural Resources Journal* 131.

In view of the importance of tax incentives to SMEs as discussed above, we now assess Australian and Egyptian experiences in terms of economic efficiency in this field.

6.2.1 Assessing economic efficiency of the Australian taxation of SMEs

The ITAA 1997 and other tax legislation grants tax incentives to small businesses based on specified criteria the most important of which is a prior year turnover of less than AUD 10 million,⁶⁴ while the Australian Small Business and Family Enterprise Ombudsman classifies small businesses into the three categories as was presented in Table 1. The bulk of small businesses are self-employed as the share of this category was 64 per cent of small businesses, followed by micro businesses with 29 per cent in 2016.⁶⁵ Therefore, these two categories have a specific significance in term of degree of risk and level of market failure. Thus, one recommendation may be to set specific tax incentives, which are tailored more closely to these categories of small business in order to create a more efficient tax system.

6.2.2 Assessing economic efficiency of the Egyptian taxation of SMEs

SMEs and entrepreneurship play an important role in economic restructuring programs in Egypt as a tool to create new jobs and reduce unemployment rates. This encourages the Egyptian government to consider the challenges facing SMEs through providing preferential tax treatment to them via a few channels including:

- (1) specific tax incentives to the SMEs financed through Social Development Fund under the Income Tax Law of 2005;
- (2) specific tax incentives to the SMEs established under Investment Law No 172 of 2017; and
- (3) specific tax incentives under SMEs Law No 152 of 2020.

These various measures designed for providing preferential tax treatments to SMEs are considered as achieving economic efficiency in order to stimulate SMEs.

In summary, it is evident that both Egypt and Australia pay attention to the taxation of SMEs through providing preferential tax treatment to them.

6.2.3 The difference between Australia and Egypt in addressing economic efficiency

The comparison between Australia and Egypt reveals that each country employs different tax measures for taxing SMEs to achieve economic efficiency. These differences are:

- (1) Australia imposes a reduced income tax rate on SMEs in order to minimise tax burden while Egypt has introduced specific tax measures that rely on lump sum and flat rate turnover taxes;
- (2) Australia provides specific tax treatments for SMEs' capital gains that are derived from disposition of capital assets whereas Egypt grants tax exemption to SMEs' capital gains which are to be reinvested in the businesses;
- (3) Australia grants tax exemption for SMEs from FBT while in Egypt there are no FBT provisions.

⁶⁴ Income Tax Assessment Act 1997 (Cth).

⁶⁵ Australian Small Business and Family Enterprise Ombudsman, above n 41.

6.3 Assessing Taxation of SMEs in Terms of Simplicity

Simplicity is also an important criterion of a good tax system since simplicity plays an important role in achieving tax compliance and enforcement of the tax law. Simplicity refers to legal provisions and regulations which are unambiguous, and so understandable by taxpayers, tax professionals and tax administrators.⁶⁶ Thus, simplicity helps taxpayers to minimise their compliance costs and the tax authority to minimise tax collection costs, which together result in lower operating costs of tax system.⁶⁷ Furthermore, one of the present authors has previously distinguished between legal simplicity and effective simplicity where legal simplicity refers to the ease by which a tax law can be understood, interpreted and applied in different circumstances and effective simplicity to the costs of operating the tax system.⁶⁸ Previous studies indicate that the compliance costs for business taxpayers are regressive as explained in section 3. In order to reduce the tax compliance burden for SMEs, Australia and Egypt have introduced specific legal provisions and administrative rulings to simplify tax compliance costs for SMEs as was elaborated in sections 4 and 5. Accordingly, we assess here simplicity of the tax treatment of SMEs in Australia and Egypt in terms of both legal and effective simplicity.

6.3.1 Assessing the simplicity of the Australian taxation of SMEs

Generally, there is a perception that Australian tax legislation is complex and there are continuous efforts to simplify it.⁶⁹ Nevertheless, there has been significant progress in simplifying tax legislation in Australia reflected in part through the introduction of various tax measures including specific tax treatment of SMEs. So, assessing the legal simplicity of the tax treatment of SMEs implies assessing the definition that is adopted of SMEs, in both provisions within the tax legislation and other regulations. Thus, based on previous analysis, we can assess the legal simplicity of the tax treatment of SMEs as follows:

- (1) the introduction of a simple definition for SMEs that is based on annual turnover helps taxpayers to identify their status and consequently comply with the provisions smoothly;
- (2) the long timeframe for implementing the self-assessment system according to specific legal provisions is important; and
- (3) the provision allowing SMEs to use a simplified accounting system is also important.

6.3.2 Assessing the simplicity of the Egyptian taxation of SMEs

An assessment of the legal simplicity of the tax treatment of SMEs in Egypt leads to identification of the following issues:

- (1) The new measures introduced through SMEs Law No 152 of 2020 for simplifying the tax treatment of SMEs as discussed before reflect legal simplicity.

66 Tamer Budak, Simon James and Adrian Sawyer “The Complexity of Tax Simplification: Experiences From Around the World” in Simon James, Adrian Sawyer and Tamer Budak (eds) *The Complexity of Tax Simplification: Experiences From Around the World* (Palgrave Macmillan, 2016) at 1, 3.

67 Phil Lignier, Chris Evans and Binh Tran-Nam “Tangled Up in Tape: The Continuing Plight of the Small and Medium Enterprise Sector” (2014) 29(2) *Australian Tax Forum* 217.

68 Binh Tran-Nam “Tax Reform and Simplification: Some Conceptual Issues and a Preliminary Assessment” (1999) 21(3) *Sydney Law Review* 500.

69 Binh Tran-Nam “Tax Reform and Tax Simplification: Conceptual and Measurement Issues and Australian Experiences” in Simon James, Adrian Sawyer and Tamer Budak (eds) *The Complexity of Tax Simplification: Experiences from Around the World* (Palgrave Macmillan, 2016) at 11.

- (2) While the ITL 2005 also includes a special provision to simplify taxation of SMEs, nevertheless some practices in the case of this measure indicate complexity, including:
- the administrative rulings that provide the SME definition set out three criteria for determining small businesses, which are (i) paid-in capital; (ii) the amount of annual turnover of a business, and (iii) the last assessed tax base. The use of different criteria may create confusion for taxpayers and advisers, so that one appropriate recommendation may be for annual turnover to be set as the main criterion. In a similar way, the executive regulations of Investment Law of 2017 set out a number of measures to grant tax exemption to small businesses;
 - the tax measures applying to SMEs are governed by both tax and non-tax laws. In this context, the investment tax law has specific tax incentives for SMEs and the new SMEs Law No 152 of 2020 provides specific tax treatment for SMEs. This situation makes tax enforcement and compliance processes complicated.
 - the administrative procedures are also complicated and lag behind those of other areas of government in Egypt, which results in lower levels of tax compliance, an increase in the number of tax disputes, discouragement of SME growth and encouragement of participation in the underground economy.

6.3.3 *Different features as between Australia's and Egypt's approaches for addressing effective simplicity*

To some extent, both countries are keen to address legal simplicity through implementation of simple legal provisions. The Australian approach focuses on procedural simplicity through introducing simple procedures that foster tax compliance by taxpayers themselves. While the self-assessment system has also been introduced in Egypt, under Law No 91 of 2005, the compliance rate by taxpayers themselves is generally low among SMEs. The SME measures implemented in Egypt generally aim to simplify the working out of tax liability, in other words to help taxpayers to comply smoothly with tax regulations in a way that is reflective of effective simplicity. Nevertheless, comparison of the two countries requires measuring effective simplicity, which can be carried out through using *Paying Taxes* index as a proxy. The *Paying Taxes* index is one indicator in the overall *Doing Business* measure, which provides a calculation of the procedures, time and costs of paying taxes. Table 4 illustrates the relative performance of both countries, based on this measure for 2020.

Table 4: Paying Taxes Indicators of Australia and Egypt, 2020

No	Indicator	Australia	Egypt
1	Overall doing business ranking	14/190	114/190
2	Paying taxes ranking	28/190	156/190
3	Number of payments	11	27
4	Required time for compliance	105	370

Source: World Bank, *Doing Business 2020: Comparing Business Regulation in 190 Economies* (2020) <www.doingbusiness.org/>.

From Table 4, we observe that:

- (1) The overall performance of Australia in paying tax is much better than Egypt given the respective rankings of the two countries of 28/190 and 156/190.
- (2) The number of annual payments in Australia is 11 compared with 27 in Egypt.
- (3) The required time for compliance annually in Australia is 105 hours compared with 370 hours in Egypt.

From the abovementioned comparison, we conclude that Australia is performing better compared with Egypt in terms of effective simplicity.

6.4 The Trade-off between Efficiency and Simplicity

Designing specific tax treatment for SMEs requires a trade-off between several tax principles, such as efficiency and simplicity. Addressing the specific characteristics of SMEs, through implementing the efficiency criterion, requires providing specific tax incentives, which may increase the level of complexity of tax legislation and resulting in negative impact on simplicity.⁷⁰ Nevertheless, tax simplicity is a broader concept than that of the tax legislation alone. Budak, James and Sawyer have identified that simplicity has several aspects including simplifying tax law, simplifying taxpayers' communications and simplifying tax administration.⁷¹ This can provide a means of interpreting the simplicity of tax treatment of SMEs in Australia in that, despite the overall perception of complexity of tax legislation, Australia is performing well in terms of effective simplicity as explained previously. This can be attributed to a few factors including: (i) the implementation of the Australian tax compliance model, which employs different means for stimulating tax compliance among businesses of different sizes,⁷² and (ii) the application of information technology in various operations of tax administration, reflected in an increase in tax compliance rate. Considering different dimensions of simplicity has enabled Australia to deliver a number of tax incentives within tax legislation to address the economic efficiency of the tax treatment of SMEs.

On the other hand, the new SME legislation in Egypt imposes a lump sum tax on SMEs to address both economic efficiency and simplicity. The design of the new tax system for SMEs is outside the ordinary income tax law as it is introduced under new SMEs Law No 152 of 2020 and its focus is to simplify the tax legislation without paying further attention to other dimensions of simplicity. The overly simplified tax treatment of SMEs in legal terms may result in adverse outcomes as follows:

- it may encourage many large businesses to split in order to enjoy a lower tax burden, a process noted by Bozdoğanoglu.⁷³ It may also discourage SME growth as businesses will prefer to remain small.
- it will represent a real challenge for the future reform of the tax system in Egypt, as it will be difficult for tax policy-makers to reintroduce a normal tax system, which is based on conventional income tax principles.⁷⁴

70 Tran-Nam, "Tax Reform and Tax Simplification: Conceptual and Measurement Issues and Australian Experiences", above n 69.

71 Budak, James and Sawyer, above n 66.

72 Robert B Whait "Let's Talk About Tax Compliance: Building Understanding and Relationships through Discourse" (2015) 13(1) *eJournal of Tax Research* 130.

73 Bozdoğanoglu, above n 23.

74 Coolidge and Yilmaz argue that simplified tax regimes for SMEs in developing countries may face some constraints that increase non-compliance rates among SMEs or hinder return to normal tax system. For more details, see J Coolidge and F Yilmaz "Simplified Small Business Tax Regimes in Developing Countries: Empirical Evidence of Use and Abuse" in Evans, Krever and Mellor (eds) *Tax Simplification* (Kluwer Law International, 2015) 309.

Nevertheless, the new design of the tax treatment for the SMEs in Egypt reflects concerns about issues common to many developing countries. Such issues relate to a number of factors such as: (1) lagging performance of the tax administration due to inefficient practices; (2) lack of information technology to manage tax compliance, and (3) the impact of socio-economic factors related to payment of tax culture which need to be considered.

7.0 CONCLUSIONS

SMEs play an important role in creating more jobs and improving economic growth rates. However, SMEs also face a number of challenges in terms of credit market imperfection and economies of scale that typically require government intervention through direct and indirect means. These challenges are similar to some extent in both developed and developing countries. Taxation is an important indirect means that is employed by government to stimulate SMEs. In that context, consideration of the income tax treatment of SMEs in developed and developing countries reveals that both groups of countries pay attention to minimising the tax burden on the SMEs through specific tax measures. The tax burden on SMEs consists of both legal tax liability and tax compliance costs. Reducing the tax liability of SMEs is implemented through providing specific tax incentives, while reducing their tax compliance costs is achieved through simplifying the tax treatment.

An examination of the Australian and Egyptian income tax experiences in taxing SMEs again reveals that both countries more particularly are interested in providing preferential tax treatment to SMEs to minimise their tax burdens. This has been reflected through introduction of specific definitions of SMEs for tax purposes that are based on annual turnover and other criteria, provision of specific tax incentives and regimes for taxing SMEs, and consideration of different dimensions of simplicity to minimise tax compliance costs of SMEs.

Conversely, the comparative analysis and assessment of the Australian and Egyptian experiences reveals that it is important to set a clear-cut and harmonised definition of SMEs that is based on a single, measurable criterion such as annual turnover, as this will provide more transparent and consistent eligibility of SMEs for preferential tax treatment. Australia employs SME tax incentives within its normal income tax legislation, while Egypt deviates from normal income tax measures in utilising lump sum and flat rate turnover taxes. This deviation from normal tax rules may encourage large businesses to split and discourage small businesses to grow to be eligible for preferential tax treatment. Further, the specific tax regime for SMEs will constrain government from carrying out any potential future tax reform in accordance with principles of normal tax regimes when there is a necessity to do so.

Australia pays greater attention to effective simplicity through implementation of the self-assessment system and enactment of specific measures embedded in the Australian tax compliance model that serve various business sizes including SMEs. Egypt is not sufficiently successful in implementing its self-assessment system, which has resulted in a high non-compliance rate. Accordingly, it has been necessary for Egypt to introduce its specific tax regime for SMEs, which deviates from normal income tax measures.

In summary, developing countries can learn how to design appropriate specific income tax measures for SMEs from the successful experiences of developed countries. In doing so, attention should be paid to the following considerations:

- it is important to introduce a simple and transparent definition of SMEs that is based on a single, measurable criterion;

- the specific income tax measures for taxing SMEs should be included within the ordinary tax legislation and they should ensure economic efficiency through the following specific provisions. First, to overcome credit market imperfection, it is recommended that tax credits for equity capital (paid-in capital) be provided. This would encourage SMEs to scale up or become listed on a stock exchange. Secondly, favourable tax treatments should be provided in relation to capital gains either through exemption or taxation of such gains at a reduced rate. Thirdly we propose the implementation of some measures which will encourage expansion of SMEs, such as hiring more workers or acquiring technology; and
- addressing the simplicity of tax compliance for SMEs requires considering not only the characteristics of the tax legislation but also other dimensions of simplicity such as correct implementation of the self-assessment system and development of tax compliance measures appropriate for different business sizes.

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