

Tax Policy and its Impact on Small Business - The Example of Georgia

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ABSTRACT

A number of stimulating actions are being implemented in the field of tax policy to develop entrepreneurship in Georgia, especially for entrepreneurs with small business status. It is expressed both in the development and implementation of various strategies, as well as in tax reforms. Nevertheless, entrepreneurs face various problems and barriers. To clarify this, a two-stage study was conducted, covering many issues, however, the aim of this paper is to identify the obstacles to entrepreneurial activity for small businesses, the type of tax with the greatest pressure, and the satisfaction of small businesses with the reforms implemented. In turn, the aforementioned data is compared with the statistical information available in the country on small entrepreneurs.

INTRODUCTION

Developing the entrepreneurial environment and supporting entrepreneurs is very important for the state, because budget tax revenues depend on the right approaches to tax policy decisions, and on the part of entrepreneurs, the expansion of their activities. All this leads to the creation of new added value and new jobs. Naturally, the development and promotion of this environment is in the interests of the state, and its attitude is expressed in the tax policy it pursues. Therefore, the tax system and related political decisions are very important for economic development, which in turn is the basis for both the improvement of socio-economic conditions and the development of entrepreneurship.

The target audience of the article is small business representatives. It is worth noting that small business representatives in Georgia are divided into several areas. The National Statistics Service divides entrepreneurs into large, medium, and small businesses. Where they differ in terms of turnover and number of employees. It is also noteworthy that the Georgian Tax Code allows certain categories of entrepreneurs to receive small business status (as well as microbusiness and fixed taxpayer) after meeting certain requirements. Accordingly, the tax reforms that have been implemented in recent years are aimed precisely at the division that the Tax Code identifies. Meanwhile, the state agency - "Enterprise Georgia", within the scope of its authority, guides the general division, which is included in the methodology of the National Statistical Service (large, medium and small) - within the scope of grants / subsidies / loans / support measures to be allocated.

RESEARCH METHODOLOGY

The purpose of the research is to study and analyze the results of the reform carried out in the direction of tax policy. The research period covers reforms implemented since 2011. Research allows us to compare the data with each other, whether the views and expectations of entrepreneurs have changed in relation to this reform. Induction and deduction methods are used. Various statistical data have been collected, both published by state agencies and the results of research conducted by the author. The research was conducted in two stages in 2019 (<https://forms.gle/kKKLiV5Hc73p69j99>) and 2023 (<https://forms.gle/aPCYekngXDLEfa4dA>). 120 entrepreneurs participated in the 2019 survey, and 510 entrepreneurs in 2023.

LITERATURE REVIEW

In terms of the size of the tax rates and the objects of taxation in the country, Georgia is one of the most liberal country in the world. However, despite this, entrepreneurs always want to have the lowest possible tax rates and, accordingly, pay as little tax as possible into the budget. Since the majority of Georgia's budget consists of tax revenues, it is necessary to maintain a balance that, on the one hand, will place less tax burden on entrepreneurs, and on the other hand, will not create a deficit in the budget due to the imposition of certain benefits and/or reduction of tax rates.

In 2011, special taxation regimes came into force in the Tax Code of Georgia, which provided for the support of entrepreneurs with low joint income, which was manifested in the fact that they were granted the status of micro, small and fixed businesses, which in turn provided various benefits.

The status of micro business could be granted to an individual who did not use the labor of hired persons and was independently engaged in economic activity, from which the total income received by him during the calendar year did not exceed 30,000 GEL. And an individual with micro business status did not pay income tax. If an entrepreneurial natural person with the status of a micro-business, who faced the obligation of mandatory registration as a value added tax (VAT) payer, he would leave the special taxation regime (Tax Code of Georgia. 2010. As of March 12, 2011).

As for the status of a fixed tax payer, it could be granted to a person who was not a value added tax payer and carried out one or more activities subject to a fixed tax and the types of activities of their taxation object were determined by the Government of Georgia. The fixed tax rate was determined by the Government of Georgia depending on the type of activity - on the object of taxation - within 1-2000 GEL or 3% of the income received from the taxable activity. The entrepreneur with the given status was also entitled, in addition to the activities subject to a fixed tax, to additionally carry out only the activities permitted by the Government of Georgia, such activities would be taxed in the general manner. In case, in the part of the additional activities allowed for the fixed tax payer, the person incurred the obligation to register as a value added tax (VAT) payer or was voluntarily registered as a value added tax payer (VAT), then the given status would be cancelled (Tax Code of Georgia. 2010. As of January 1, 2012).

Small business status in Georgia was defined by the Tax Code and came into effect on January 1, 2011 to provide certain benefits to taxpayers with relatively low joint incomes. After the introduction of the status, an additional change was made in 2018 for the benefit of taxpayers. However, with the mentioned change, it can be said that the state budget has lost certain revenues, and certain risk factors have also been created, which may further reduce the state's revenues. Initially, when the small business status was introduced in the tax legislation (2011), it could be granted to an entrepreneurial individual whose total income from economic activities (The Government of Georgia has the right to prohibit the implementation of separate activities, within the scope of which the status of small business cannot be granted to an entrepreneurial individual) did not exceed 100 thousand GEL during a calendar year, and taxable income was taxed at 5%. If an individual entrepreneur with the status of a small business had documents confirming the expenses of 60% of the total income (except for the salary expenses charged to employees), it was taxed at 3%. If the taxable income of an entrepreneur with the status of a small business exceeded 100 thousand GEL, then he had the obligation to register as a VAT payer, which in turn meant the cancellation of the status of a small business (Tax Code of Georgia. 2010. As of March 12, 2011). On July 1, 2018, the Tax Code was amended and the joint income limit for small businesses increased from 100 thousand GEL to 500 thousand GEL. Taxable income is taxed at 1% instead of 5%, however, it is taxed at the rate of 3% if its total income from economic activity exceeds 500 thousand GEL. A person with the status of a small business is taxed at the prescribed rate from the beginning of the relevant month (in case of exceeding the limit of 500 thousand GEL of joint income) to the end of the calendar year. However, the status of a small business is canceled if the joint income received from economic activities of a person exceeds 500 thousand GEL in each calendar year, according to two calendar years. As for VAT registration, it does not conflict with the small business status, as it was in the first case (Tax Code of Georgia. 2010. As of July 1, 2018). Therefore, it can be said that those entrepreneurs who have been granted the status of a small business have received pronounced benefits as a result of the measures taken by the tax policy, which were manifested both by increasing the joint income limit and by reducing the rate of taxable income. As of today, the Tax Code provides for the following special taxation regimes (which are qualitatively related to small businesses): An individual with micro business status, an individual entrepreneur with small business status, and an individual with fixed taxpayer status. The main characteristics of these statuses have already been discussed above and remain the same today. As for the reforms planned in this direction in the future, it is worth noting that the following changes are planned to the Tax Code of Georgia from January 1, 2025, in terms of the status of small businesses - "In agreement with the Finance and Budget Committee of the Parliament of Georgia, the Government of Georgia has the right to determine the types of income that will not be taxed under a special regime and will not be taken into account in the calculation of the GEL 500,000 limit of total income received during a calendar year established for an individual with small business status, and in the case of a wine tourism entity and agritourism entity - the GEL 700,000 limit" (Tax Code of Georgia. 2010. As of December 10, 2024). This is identical to the change made in 2018, when the GEL 100,000 limit for total income received was increased to GEL 500,000, and in this case, the already increased GEL 500,000 limit is increased to GEL 700,000 for specific business activities.

Several agencies have been established in Georgia, which are committed to promoting and supporting the development of small and medium-sized businesses, both in terms of financial, legal and business planning. "Enterprise Georgia" is a state agency in Georgia,

whose main goal is to improve the entrepreneurial environment, develop the private sector, promote Georgia's investment climate and promote exports. The agency combines three components: business (local production), export and investment. The goal of the "Enterprise Georgia - Business" direction is to develop entrepreneurship in Georgia, support entrepreneurs, promote the creation of new enterprises and expand or re-equip existing enterprises. The goal of the "Enterprise Georgia – Export" direction is to promote Georgia's export potential, increase the competitiveness of Georgian products in international markets, increase the export volume of Georgian products, and diversify Georgia's export markets. The goal of the "Enterprise Georgia - Invest" initiative is to attract, promote and develop foreign direct investment in Georgia. This initiative acts as a mediator between foreign investors and the Georgian government, operating on a "one-stop shop" basis and helping interested investors obtain information and communicate effectively with the Georgian side.

From the perspective of small business, the direction of business is important, which implements various mechanisms necessary for the development of entrepreneurship in Georgia. Among them, it is important to highlight such directions that directly contribute to the development of small business, these are:

- **Business Universal** - the goal of the program is to develop entrepreneurship in Georgia, support entrepreneurial entities, promote the creation of new enterprises/expansion/re-equipment of existing enterprises and increase the competitiveness of the private sector by increasing access to finance. The target industries of this program are the following: industrial, hotel industry/balneological resorts, tourist services, agro-tourism industry and eco-tourism industry. However, it is worth emphasizing that priority areas of activity have been selected for greater specificity of these areas.
- **Credit Guarantee Mechanism** - The Credit Guarantee Mechanism involves issuing credit guarantees to viable small and medium-sized enterprises that are unable to meet the existing loan collateral requirements. The target audience of this program is: agriculture, forestry and fishing, manufacturing, gas, steam and air conditioning supply, wholesale and retail trade; repair of motor vehicles and motorcycles, transport and storage, accommodation and food service activities - minimum hotel criteria, information and communication, professional, scientific and technical activities, administrative and support service activities, education, health and social service activities, arts, entertainment and recreation.
- **Micro-Entrepreneurship Support Program** - The goal of the program is to promote micro-entrepreneurship in Georgia, create new jobs, and increase the competitiveness and entrepreneurial potential of the private sector. More than 300 economic activities are financed within the framework of the program. The main thing is that they meet the following conditions: a) The income of entrepreneurial entities should not exceed 500,000 GEL, b) They should not have tax debts to the state, c) they should not be registered in the debtors' register, d) The income of the founder/shareholder of the entrepreneurial entity should not exceed 100,000 GEL, e) The founder/shareholder of an entrepreneurial entity, a legal entity or an individual entrepreneur, complies with the requirements set for a Category IV enterprise (the same as a small business) only in the revenue component, in accordance with the Law of Georgia "On Accounting, Reporting and Audit".

If we look at the activities implemented under these programs: the number of new projects in the credit-guarantee direction is increasing every year, and accordingly the total loan volume is also increasing in parallel. The rate of new jobs/employment within the framework of these projects is also increasing (see Table 1).

Table 1. Credit Guarantee Scheme

Direction	2020	2021	2022	2023	Total
Number of new projects	123	200	325	340	988
Number of restructured/ refinanced projects	15	5	6	6	32
Number of closed loans	22	28	10	-	60
Total number of loans	160	233	341	346	1,080
Total volume of loans	135,461,996	178,214,236	267,787,063	230,815,608	812,278,903
Total amount of guarantee	112,279,330	144,215,185	176,513,389	164,575,305	597,583,209
Total jobs created	3,035	3,024	3,808	3,844	13,711

Source: Enterprise Georgia

As for the micro-grants direction, the goal is to develop micro and small businesses, establish a modern entrepreneurial culture, and create new jobs by providing the necessary financial support and technical assistance for starting new businesses and/or retooling existing businesses. Financial support involves the allocation of targeted grants to potential beneficiaries. In this regard, the trend of statistical data is variable, although it is represented by a significant contributory share in the market (see Table 2).

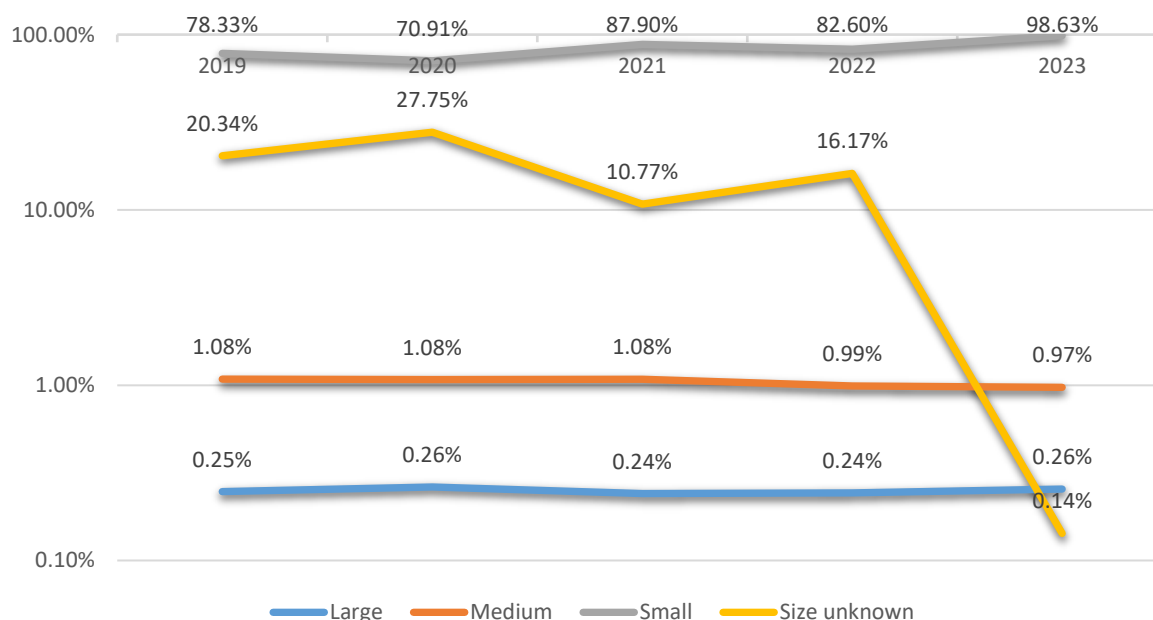
Table 2. Micro Grants Direction

Year	Number of projects	Number of beneficiaries	Employment
2015	608	859	1374
2016	2596	4055	6488
2017	2109	3498	5597
2018	899	972	1555
2020	689	689	2432
2022	1308	1308	3739
2023	1140	1140	2651
Total	9349	12521	23836

Source: Enterprise Georgia

Before we get acquainted with the existing information and statistics about entrepreneurs based in Georgia, it is worth noting that there is a gradation of entrepreneurs in the country, according to which Enterprises are grouped by size as follows: large, medium and small. Enterprises of any organizational-legal form where the number of employees and annual turnover: a) Do not exceed 50 employees and 12 Mln. GEL are small enterprises; b) Do not exceed 249 employees and 60 Mln. GEL are medium enterprises; c) Exceed 249 employees or 60 Mln. GEL are large enterprises.

Since our target audience is small and medium-sized entrepreneurs, according to data from the National Statistics Service, the number of small and medium-sized entrepreneurs in the country has been growing significantly in recent years (see Figure 1).

**Figure 1. Number of business entities operating in Georgia by size**

Source: National Statistics Office of Georgia

As for the types of activities of these entrepreneurs, as of 2023, the top five activities of small entrepreneurs are as follows: wholesale and retail trade; repair of automobiles and motorcycles; transport and storage; information and communication; construction; manufacturing. As for the same indicators in terms of medium-sized entrepreneurs, they are as follows: wholesale and retail trade; repair of motor vehicles and motorcycles; construction; manufacturing; health care and social service activities; accommodation and food supply activities. However, it should be noted that in recent years, the information and communication segment, which was not in the top five in previous years, has emerged in the top five. In previous years, its place was taken by activities such as providing accommodation and providing food. To compare these activities with those of large entrepreneurs, “Arts, entertainment and recreation” and “Financial and insurance activities” are added to the activities already mentioned.

As for the share of products produced by entrepreneurs according to their size, turnover and number of employees, it is interesting to analyze the given data, which allows us to clearly see the role of small and medium-sized businesses in terms of entrepreneurship development in Georgia (see Figure 2).

Statistical data on turnover shows that although the share of large entrepreneurs in the overall indicator is large, according to the trend of recent years, their share is increasing even more, which is reflected in the decrease in the share of turnover of small and

medium-sized businesses. Therefore, although the state implements certain support measures for small and medium-sized businesses, as statistics show, they are insufficient.

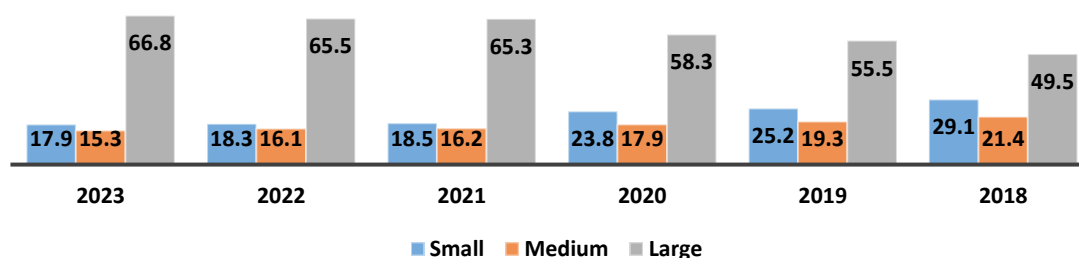


Figure 2. Share of turnover by size of enterprises (percent)

Source: National Statistics Office of Georgia

As for the reconciliation of the existing data by share of output, the aforementioned trend shows the same trends as the overall turnover indicators, i.e. here too, the growth rate of output of large businesses is observed, at the expense of the decline of medium and small businesses (see Figure 3).

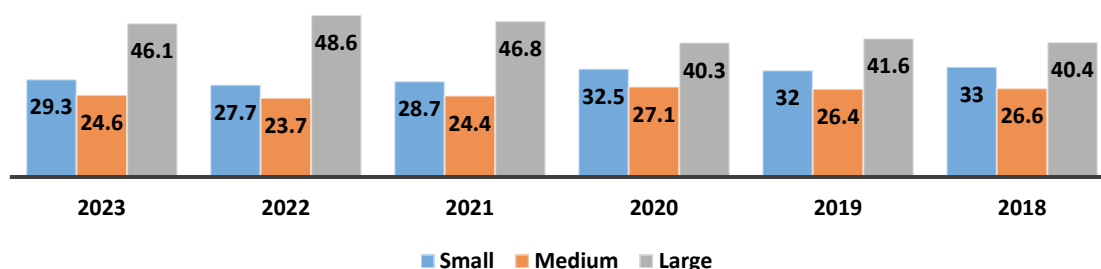


Figure 3. Share of output by size of enterprises (percent)

Source: National Statistics Office of Georgia

As for the review of employment indicators by enterprise size, naturally the trend of previous indicators is directly proportionally reflected here as well, although it is worth noting that the numbers of people employed by large and small businesses are almost equal, which means that this sector has a significant contribution to the creation of new jobs and is quite competitive with large businesses in this area (see Figure 4).

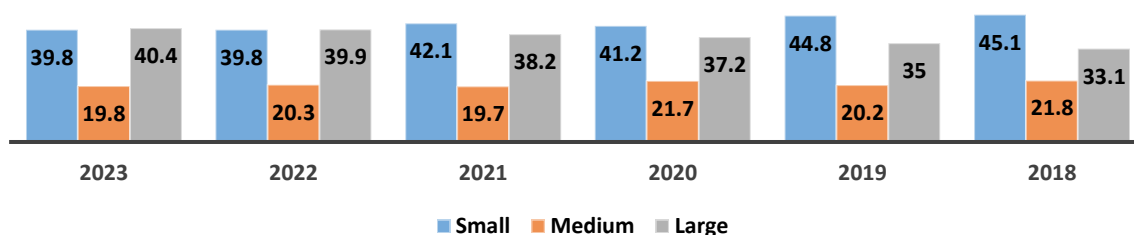


Figure 4. Share of employed persons in by size of enterprises (percent)

Source: National Statistics Office of Georgia

By analyzing the implemented legislative reforms, statistical data, and measures taken by the state, we can say that the implemented legislative reforms were aimed at supporting small businesses, which were also accompanied by supporting measures implemented by the state agency "Enterprise Georgia", however, the measures implemented based on statistical data are insufficient at this stage.

RESULTS AND DISCUSSION

As a result of analyzing existing materials and statistical data, it is interesting to analyze the results of the existing target group survey, which was conducted in two stages - in 2019 and 2023. This study allows us to compare the level of satisfaction of small business representatives with the implemented reforms (which were specifically designed for small businesses) over a certain period

of time, as well as to identify factors hindering their activities. It is also interesting to know which taxes are a burden for them and which rates they would like to reduce in order to conduct their activities more efficiently.

First of all, it is interesting to understand the satisfaction of small entrepreneurs with the introduction of micro, small and fixed taxpayer status. These statuses were established in the Tax Code of Georgia in 2011, which was modified and improved in 2018 in the small business section. First of all, it is interesting for entrepreneurs with small business, how positively influenced by such reforms as: the introduction of small / micro and fixed statuses. As expected, the data from both years shows that the reform has a positive impact for the absolute majority, while no negative impact was noted by the surveyed entrepreneurs in any year (see Figure 5). A comparison of the aforementioned years clearly indicates that the expectations of entrepreneurs have been met. Also, in the 2023 survey, 93% of entrepreneurs noted that the implementation of the additionally modified reform on small entrepreneurs had a positive impact on their activities. The aforementioned reform envisaged increasing the upper limit of joint income, so that they could still benefit from the existing benefits provided for small businesses.

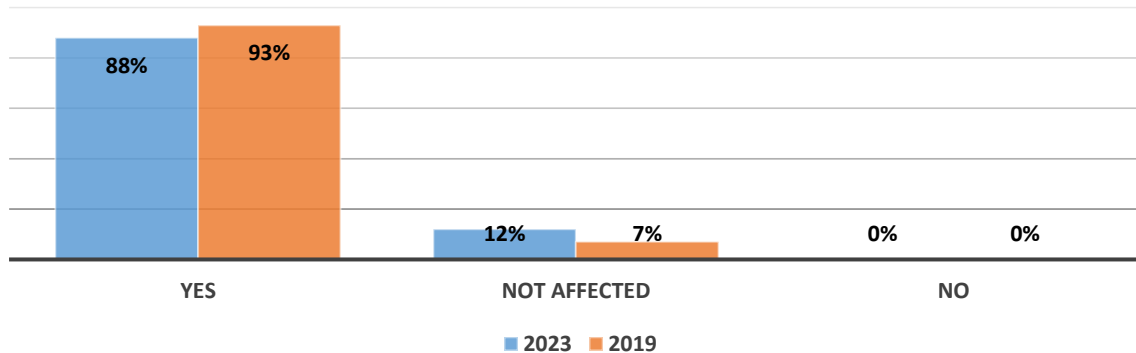


Figure 5. Positive impact of introducing small/micro/fixed taxpayer status according to entrepreneurs
Source: Author's research

The opinion of entrepreneurs regarding the reduction of existing tax rates in Georgia was also interesting for the purpose of the research (the Tax Code of Georgia defines 6 types of taxes). To identify which tax rates impose the greatest burden on them, surveyed entrepreneurs believe that reducing tax rates is desirable for almost all taxes in order to facilitate their activities and have a positive impact. First of all, we should focus on the rates themselves, which are: profit tax 15%, income tax 20%, value added tax (VAT) 18%, property tax 1%, while import and excise tax rates are not fixed and vary depending on the product. In their view, the diagram shows which tax rate reductions could positively impact their activities (see Figure 6). A comparison of both years shows that the first two places remain unchanged, namely: in first place and the desire of the majority is to reduce the income tax rate, and in second place is to reduce the value-added tax rate. A comparison of these years showed that the third position has changed, namely, if according to the 2019 data, entrepreneurs wanted to reduce the excise tax rate, according to the 2023 data, the third position is already occupied by the desire to reduce the profit tax rate. As for the last position, as expected, in this case property tax is presented, since as is known, the maximum limit of its tax rates does not exceed 1% of the property value.

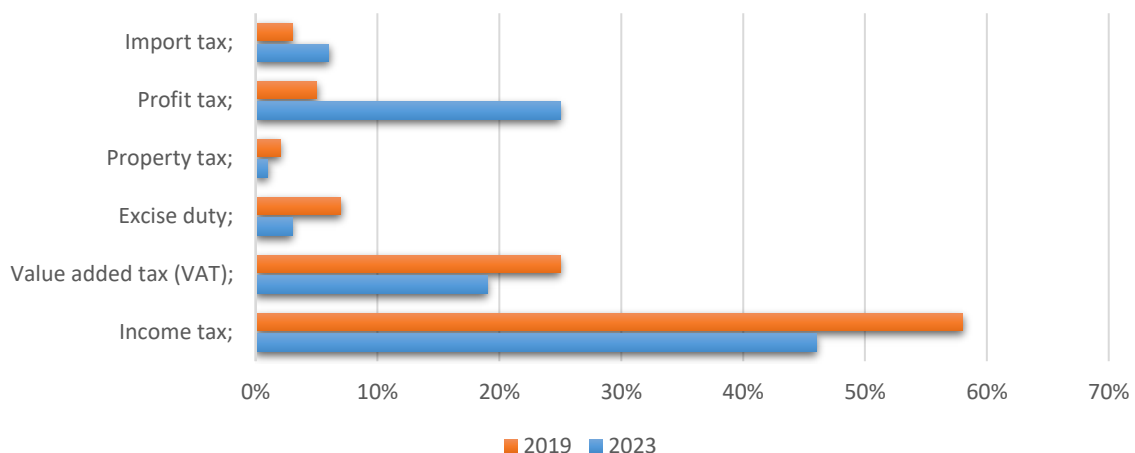


Figure 6. Desirable reduction in tax rates for entrepreneurs
Source: Author's research

It is also important to identify the problems and barriers that entrepreneurs face. When we consider the research, it is necessary to discuss such an issue as the hindering factors for small entrepreneurs, because the given category is represented by a quantitatively large share (Despite the small financial stake). Despite a number of measures taken by the state, which were aimed at providing them with both financial and technical support, it is natural that it is not intended for the full number of entrepreneurs, and this remains a challenge for a number of entrepreneurs.

Here we have the opportunity to compare studies from three different years. This will allow us to compare the problems of a given period, whether the situation has changed in this regard, whether any problems for entrepreneurs have been eliminated or whether new barriers have been added to their activities. Based on Erkomaishvili's research, the main factors hindering the development of entrepreneurship in Georgia as of 2016 were considered to be: market vulnerability to counterfeit and low-quality products; lack of raw materials required for production in the local market; difficulty in obtaining credit resources; high tax rates; excessive interference of regulatory authorities in the activities of the firm; insecurity of business interests; high interest rates, etc. (Erkomaishvili, 2016). As for the comparison between 2019-2023, the survey of entrepreneurs revealed that the main obstacles and problems to the development of entrepreneurship are several fundamental problems that prevent their activities from developing (see Figure 7).

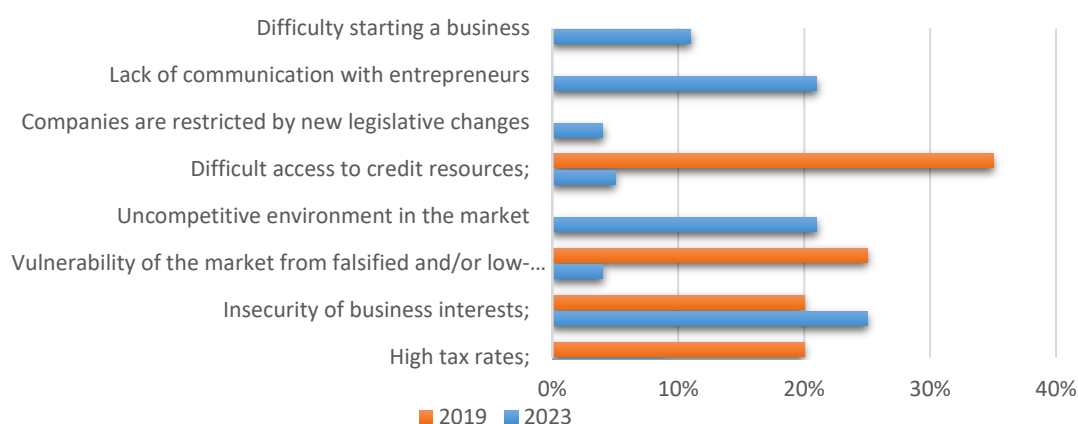


Figure 7. Obstacles for small entrepreneurs
Source: Author's research

Based on a comparison of 2016 and 2019, it was revealed that market vulnerability to poor-quality products, difficulty in obtaining credit resources, high tax rates, and insecurity of business interests were all problems faced by entrepreneurs in 2016 and remained as hindering factors in 2019. As for the barriers that existed in 2016, such as: the lack of raw materials needed for production in the local market, excessive interference of regulatory authorities in the firm's activities, and high interest rates, based on the 2019 survey, no existing problems were noted by entrepreneurs.

As for the comparison between 2019 and 2023 - for 2019, there were 4 problems of almost equal importance: High tax rates; Insecurity of business interests; Vulnerability of the market from falsified and/or low-quality products; Difficult access to credit resources. And by 2023, these problems remained, although the percentages have changed substantially and decreased, for example: if the difficulty of obtaining credit resources was a problem for 35 percent, in 2023 this figure has dropped to 5%. In this, we can see a connection to the grants and loans provided by "Enterprise Georgia" to small entrepreneurs, which have facilitated access to financial resources. However, in 2023, different problematic issues were observed that were not observed in previous years. Among them, the most notable are the Uncompetitive environment in the market and Lack of communication with entrepreneurs. These require work by specialized agencies (e.g., the Competition Agency).

CONCLUSION

Based on the results of the conducted research and the analysis of statistical materials, we can say that the tax reforms implemented by the state, which were designed for small entrepreneurs based on a survey of entrepreneurs, are considered positive by them according to the results of both years of research, which was carried out with a 4-year interval. As for the hindering factors, small entrepreneurs still have certain hindering factors at this stage that hinder their activities. However, if we compare the studies of two different periods, we will see that some of the existing problematic issues are decreasing in percentage terms and new problematic issues are emerging. For example, we can cite "difficulty in obtaining credit resources", which was a problem for the vast majority according to the 2019 survey, however, if we draw a parallel with the loans issued to small entrepreneurs by "Produce Georgia", according to the 2023 survey, this problematic issue already concerns only a small number of entrepreneurs. However, if we generalize the barriers, they still create difficulties for small businesses.

In the future, it is desirable to conduct research in this direction at certain intervals to compare data and identify both problematic issues and eliminated hindering factors. Attention should also be paid to the planned reforms aimed at supporting small businesses. Within the framework of this study, the following nuance should be emphasized: since a certain portion of entrepreneurs participated in this study, this study cannot be generalized to the views of all entrepreneurs in Georgia. It is also important to note that when researching sensitive topics such as tax reforms, taxation features, and their impacts, entrepreneurs often refuse to participate, which further complicates the study of this area and the assessment of impacts by entrepreneurs.

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