

TAX REGIMES IN THE USA: THE REVIEW AND THE EFFECT ON SMALL BUSINESSES*

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Abstract

Subject. The article discusses the development of small businesses in the USA through supporting measures.

Objectives. We suggest how small businesses should be supported and developed by analyzing the relevant practices in the USA. We also identify and analyze factors and conditions that contribute to the development of small businesses through supportive measures taken in the USA.

Methods. We use the methods of analysis, synthesis and logic research through the creative data approach.

Results. In this article we analyze the specifics of tax treatment of business and small business, first of all, in Foreign Trade Zones and in the USA as a whole. We reveal special tax regimes in the USA, referring to the business environment of SME in Russia just for the sake of comparison. Having analyzed relevant positive practices in the USA, we suggest how small businesses should be supported and developed in Russia, which is the novelty of this study.

Conclusions and Relevance. We conclude that the apparatus the USA uses to bring its small business sector to the international market and expand its operations, helps businessmen increase their profit and sales, get more free from seasonal fluctuations and turbulence in the domestic market and receive real financial aid. Supporting the

small business, the State should prioritize ensuring sufficient jobs for the people, including the creation of additional ones.

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Introduction

Small and medium-sized entrepreneurship (SME) and its development is a crucial metric of the socio-economic situation in the country. Currently, SME are actively involved in market relations of most countries.

There have been multiple studies published on SME accounting in Russia and abroad [1–11]. However, the accounting system often depends on the tax regime, which has been insufficiently studied. We herein analyze the tax regime for business and small one, primarily, referring to the U.S. tax practice.

There are totally 23 million SME and 6 million SME in the USA and Russia respectively. SME employ 65 percent and 26 percent of people in the USA and Russia respectively. SME on average account for 53 percent of GDP (small entities generate > 55 percent of turnover) and 23 percent in the USA and Russia respectively¹.

In 1953, the USA passed the Small Business Act. It underlay the establishment of the Small Business Administration (SBA). It pronounced the following priorities:

- 1) evaluating the legislative and normative acts, taxation that govern SME operations, and studying the business environment, where small businesses work in the USA, and their activity directly;
- 2) assisting small businesses in entering governmental contracts and transacting with governmental institutions;
- 3) nurturing businesses to grow in numbers in those regions where the development quality factors are lower than on over across the USA;
- 4) gratuitous financial aid to non-profits, entities and lessees that suffered from natural disasters, etc.

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¹ Filin S.A., Beisenova M.U., Ibraimova C.C. [SME taxation in the USA]. *Put' Kazakhstana: 25 let mira i sozidaniya s liderom natsii: trudy Mezhdunarodnoi nauchno-prakticheskoi konferentsii, posvyashchennoi 25-letiyu nezavisimosti Respubliki Kazakhstan* [Proc. Int. Sci. Conf. The Path of Kazakhstan: 25 Years of Peace and Constructive Living with the National Leader]. Shymkent, ASU Publ., 2016, pp. 315–319.

SBA took part in the establishment of the national SME support project in the USA, i.e. for methodological, financial, technological and innovative assistance. For instance, small *infant* businesses are granted loans on beneficial terms as grants for 7 to 10 years (3 to 5 years from commercial banks). Although SBA does not provide direct financial aid to small businesses, it acts as a guarantor that loans below USD 10 million be repaid, by issuing surety bonds as part of the loan guarantee program for those institutions that lend to small businesses, thus reducing their risks, helping them secure loans above USD 50 thousand. Using its guarantee mechanism, SBA encourages affiliated private investment funds to put up their money in small businesses' securities. In their turn, investment fund repay loans, which they received from SBA, for 7 to 10 years.

As part of the SBA microloan program, small businesses will get them on preferential terms for their own growth. To raise the competence of entrepreneurs for their future growth, based on various platforms, such as the entrepreneurial learning platform, and online courses, entrepreneurs can attend special courses, read relevant educational guides, etc. It is often free of charge for start-ups. As part of special educational projects, educational institutions disseminating small entrepreneurship.

Innovation companies often give additional impetus to the economic development and take global leadership. The U.S. Administration emphasizes the development of innovative entrepreneurship by expanding the cooperation of small and large businesses, luring to provide aid to the small one and involving them both in governmental contracts. As enshrined in the Small Business Innovation Development Act of 1982, the priorities are as follows:

- 1) cultivating the use of innovative technologies;
- 2) performing governmental R&D jobs by engaging SME capabilities;
- 3) attracting researchers and inventors who are prominent in technological innovation;
- 4) involving SME into the U.S. qualification list enumerating those businesses that operate in the innovative area in order to satisfy national interests.

SBA also focuses very much on short-term innovation projects, which may possible generate high return and create new high-tech workplaces.

Besides SBA, the United States Association for Small Business and Entrepreneurship (USASBE) and the International Council for Small Business (ICSB) are in charge of the development, monitoring, examination of relevant aspects, research for addressing SME's difficulties to mitigate business risks and control small business for their future growth². They raise the public awareness to the above issues.

There is the Women Business Council (WBCs) in the USA. It is intended to create equal conditions for young entrepreneurs, notwithstanding their gender, by providing them with advice and additional educational support. WBCs is a national network of 100 educational centers.

To understand the fiscal environment the U.S. businesses operate in, and small business in particular, we analyze key taxes. The U.S. taxation system operates at the federal, local and state

² Abdukhmanov Kh.A., Filin S.A. *Problemy, svyazannyye s razvitiem innovatsionnogo malogo i srednego predprinimatel'stva v Rossii. V kn.: Innovatsii v upravlenii sotsial'no-ekonomicheskimi sistemami (RCIMSS-2020)* [Innovative SME development issues. In: Innovation in socio-economic system management (RCIMSS-2020)]. Moscow, RuScience Publ., 2020, pp. 25–37.

levels. There are respective tax services at each level. Key taxes include personal income tax, corporate tax, social security charges and sales tax. Taxes are levied independently at the federal and state level, with each state having its own fiscal agency.

Let us focus on the design of the U.S. taxation.

Table 1 enumerates key taxes levied at a respective level. Some other types of taxes are charged concurrently at several levels.

Fig. 1 shows the percentage of total taxes collected by federal, local and state authorities.

Rates of corporate income tax are as follows at the federal level given the income is taxable:

- 1) \geq USD 50 thousand to USD 75 thousand – 15%;
- 2) > USD 75 thousand up to USD 10 million – 18%;
- 3) > USD 10 million – 34%.

Corporate income tax averages slightly more than 6 percent across the U.S. states. As these are large entities that account for the highest amount of fiscal revenue, tax service focuses specifically on the audit of the above entities at all governmental levels.

Corporate income tax and personal income tax are the main sources of revenue of the federal budget and states' budgets. However, corporate income tax accounts for fewer fiscal revenue in the USA, like it happens in the most of other countries, being outperformed by personal income tax by 5.5 times (*Fig. 2*).

Most receipts to local budgets are generated by property taxes, personal income taxes, sales tax, and some current payments and receipts from the superior budget.

Let us look as the taxes levied on the U.S. businesses.

The U.S. businesses mainly operate as Limited Liability Company (LLC) and the corporation.

Corporation is a legal entities, with its income subject to double tax, i.e. corporate income tax and capital gain tax paid by shareholders from dividends they receive from the corporation after all the taxes are settled.

- *C-corporations* pay corporate taxes on their own behalf at the federal and state levels.
- *S-corporations* do not pay corporate pay on their own behalf, but their shareholders do so.

Transnational corporations (TNCs) are bound to pay taxes from all their global operations [12] on the cross-jurisdictional principle of *proportionate divide*, which prevents tax evasion in any state until any of TNC's units operates there³. This is an example of the arm length's principle, which implies methods of functional and fact analysis of TNC's global tax base. It is viewed as a proportion, with its inputs being assessed with respect to risks and functions of TNC's structures through the quality analysis⁴.

³ *Mirovaya ekonomika i mezhdunarodnye otnosheniya: uchebnik: v 3 t. T. 1* [World economy and international relations. Three volumes. Vol. 1]. Moscow, Vysshaya shkola Publ., 2014, p. 14.

⁴ Velikorossov V.V., Chaikovskaya L.A., Filin S.A. Transfer Pricing for Taxation of Transnational Corporations under Innovative Economy Conditions. 2nd International Conference on Contemporary Education and Economic Development (CEED 2019). Education, Science, Technology, Innovation and Life. Clausius Scientific Press, 2019.

From tax perspectives, *Limited Liability Companies* can act as C-corporation, but they pay taxes solely on profit they earn in the USA. If the entity is incorporated as partnership, each partner pay taxes individually.

Corporate income tax accounts for 10–12 percent of total taxes levied at the federal level in the USA. Taxable income is assessed as a difference between total income and expenses incurred to earn income. Currently, the *federal capital income tax* rate is 21 percent in the USA.

Corporate income tax is levied in 44 states (at the same rate in 34 states). The same tax rate is applied to personal income tax and corporate income tax in seven states.

Property tax is the most critical and substantial local tax. It is not collected at the federal level.

Although taxes may significantly differ across the country, they still have some common qualities. The property tax obligation arises if an individual or entity hold any property. Taxable property can be qualified as immovable and personal property. Personal property may be held on the commercial and individual (household) basis. The first type may be fully subject to tax (for example, TVs in hotels), while the personal holding of the same property is not subject to tax.

Property tax implies the assessment to determine the way the tax burden should be shared. The assessed value can be measured solely by the official appraiser in charge of the appraisal list. In any area, the assessed value should account for a certain share, which is called the valuation ratio, of the market value of each appraised item.

State governments usually relief from property taxes the property held by non-profit educational institutions, charitable and religious organizations. Property tax is not applied either to the property held by official governmental bodies.

Sales tax was introduced in the USA in 1951, applying to all retail. Property is exempt from sales tax. Sales tax has been levied on transportation, hospitality, business and telecommunications services and local telephone connection services for the recent years. All the services are supposed to be subject to sales tax within the coming years in the USA.

It is a kind of VAT, but it is levied only in the USA and 46 states only. Sales tax rates ranges between 3.1 percent to 7 percent.

38 states' municipalities are entitled to charge sales tax beyond the tax collected in a respective state. For instance, in Georgia, the sales tax rate is 6 percent, with 4 percent being remitted to the state budget and 2 percent going to the local budget.

So, we should not overlook *capital gains tax*, i.e. dividends, income from sale of asses (stocks, land, business, etc.).

Table 2 indicates capital gains tax rates in the USA in 2020 for non-current assets (held for more than a year).

Mandatory taxes levied on small businesses in the USA:

- 1) federal level: income tax, social security charges, unemployment tax, excise tax;
- 2) states: income tax, turnover tax, unemployment tax;

3) income tax, property tax, licenses.

The U.S. small business pay the main federal taxes at the following rates.

1. Income tax at the federal level mainly depends on the legal form of the entity. Small businesses may be represented as sole proprietorship, limited or unlimited partnerships, ordinary corporation. Sole proprietorship constitutes the principal legal form of small business in the USA. Sole proprietorship account for 71 percent of all businesses there. The overwhelming majority is small business, where the entrepreneur mostly works without any hired manpower. Due to the fact, people in the USA believe that sole proprietorship is a kind of small business. Sole proprietorship can be different in scale, ranging from a retail mini-shop in a residential building up to an industrial enterprise with the million-fold value. Income tax is withheld once a week or a month, depending on total salaries of employees. Ordinary small corporations pay 26,9 percent of payroll taxes, including the federal income tax (FIT) as set forth in the laws of a respective state and the amount of income, and the Federal Income Contribution Act (FICA). The effective rate is 19.8 percent, 23.6 percent and 13.3 percent for business, small partnerships, sole proprietors with the minimum headcount respectively.
2. The income tax rate (15 to 35 percent) includes the fixed amount and the percentage of profit earned.
3. Sales tax (for companies repurchasing goods for further resale) varies from 7.25 percent to 8.75 percent across the states, and is not levied in some states.
4. Real estate tax is levied at a 6.25 percent rate.
5. Businesses also pay unemployment insurance tax and compensatory tax⁵.

As per the U.S. tax laws, small businesses can also be qualified as C-class, i.e. individuals, and pay personal income tax only, correspondingly.

There are versions of free (special) economic zones in the USA – Foreign Trade Zones located in the USA, however legislatively viewed as areas outside the customs zone and regulated by the U.S. Customs, a unit of the Department of Commerce dealing with FTZ, the Foreign Trade Zones Act of 1934 and administrative documents of Foreign Trade Zones Board. There are General Purpose Zones and subordinate Special Purpose Subzones, which are recognized as FTZ to handle some operations and deals with some users. There are tax benefits and lower tax rates for smaller businesses in FTZ.

In FTZ, the U.S. Customs exclude full/some profit, overhead expenses and cost of services and the U.S. manpower out of taxable cost of goods produced in FTZ from the so called *unprivileged* U.S. products or imported products.

For purposes of comparison, we will describe the environment where the Russian SME operate in.

Permitted to keep accounting records in a simplified manner, small businesses submit financial statements and tax returns only on the year results before March 31. If entities are subject to

⁵ Filin S.A., Beisenova M.U., Ibraimova C.C. [SME taxation in the USA]. *Put' Kazakhstana: 25 let mira i sozidaniya s liderom natsii: trudy Mezhdunarodnoi nauchno-prakticheskoi konferentsii, posvyashchennoi 25-letiyu nezavisimosti Respubliki Kazakhstan* [Proc. Int. Sci. Conf. The Path of Kazakhstan: 25 Years of Peace and Constructive Living with the National Leader]. Shymkent, ASU Publ., 2016, pp. 315–319.

general tax treatment, they must report on a quarterly basis. Under the simplified tax treatment, businesses remit only advance payments for the single tax. The advance payments are calculated on the basis of the Income and Expense Ledger. The Income and Expense Ledger can be kept in hard copy or electronically.

Individual entrepreneurs are not bound to keep accounting records. Small businesses can accrue depreciation charges only once a year, write off raw materials and supplies immediately, rather than as they get obsolete. Controlling authorities are allowed to audit small businesses within ≤ 50 hours per year (≤ 15 hours per year for microbusinesses). Tax authorities grant a two-year tax holiday for new individual entrepreneurs providing services to the public, engaged in production or scientific activities.

Small businesses subject to the general tax treatment pay the same taxes like other entities under the same tax regime. Individual entrepreneurs pay personal income tax as follows. Based on data submitted by the entity on the expected income, tax authorities assess personal income tax for a calendar year. Individual entrepreneurs pay advance taxes throughout the fiscal period and submits the tax return on the actual income and documented expenses that directly relate to the income. Tax authorities refer to the fresh data to assess the tax base and restates the yearly tax.

To apply for the simplified tax treatment, the following conditions should be met:

- 1) average headcount for the fiscal period ≤ 100 people;
- 2) sales income net of VAT \leq RUB 112.5 million for nine months preceding the year when the simplified tax treatment is anticipated;
- 3) residual value of fixed assets \leq RUB 150 million;
- 4) other entities hold $< 25\%$ in the small business's capital⁶.

Individual entrepreneurs has been allowed to exceed the limit set by the simplified tax treatment in 2021. Individual entrepreneurs will not lose their entitlement to the special tax treatment, if their income exceeds RUB 200 million. Average headcount can be increased up to 130 people. In this case, the tax rate will rise from 6 percent to 8 percent if the individual entrepreneur accounts for *income*, and up to 20 percent if it accounts for *income less expenses*. Total tax will be assessed separately at each rate.

Based on the study, we can provide the following recommendations.

1. Russia may ensure positive trends in SME growth by adopting some successful practices of the USA in terms of SME funding and a possibility to regulate SME taxation in the Russian regions with respect to its development level [13]. In such circumstances, we should suggest developing the innovative fiscal management of the company⁷.
2. Drawing upon the special tax regimes and more flexible rates, the government may nurture a growth in the Russian SME as a vehicle of additional employment and self-employment [14].

We make the following conclusions as a result of the study.

⁶ The simplified tax treatment is not permitted for banks, insurance and investment companies, pension funds, stock market actors and some other businesses.

⁷ Filin S.A., Chaikovskaya L.A. [Innovative management of the company and innovative tax management as its constituent]. *Audit i finansovyi analiz = Audit and Financial Analysis*, 2012, no. 6, pp. 326–335. (In Russ.)

1. The government mainly supports small businesses in the USA as follows: a) cultivating the development of export implemented by small businesses; b) tax benefits; c) many operating entities specializing in educational and information assistance and advice to managers and entrepreneurs; d) a greater focus on guarantee-backed lending programs in case of various business funding mechanisms. Using the above tools intended to bring small businesses to the international market and expand its operations, entrepreneurs can increase profit and sales, reduce the dependence on seasonal fluctuations and turbulence of the domestic market, and secure real funding.
2. Supporting and developing small businesses in the USA, the priority is the possibility to provide sufficient jobs to people and, *inter alia*, the creation of additional workplaces, rather than simply increasing the volume of fiscal revenue as a result of business operations.
3. Despite the existing taxes on business, small businesses do not pay them, since only 25 percent of them are corporations, with the other ones (75 percent) being unable to bear the tax burden of corporate taxes.

Conclusion

As set forth by SBA, a business is qualified as small in the USA, if it employs less than 500 people and 1000 people in the case of computing businesses [15]. Hence, small business in the USA resembles the Russian SME in terms of headcount. The national mentality of people and the federal architecture of the USA help small businesses consider a substantial tax burden as a positive impetus for personal business growth. In the USA, the most of small business taxation laws are set up by states, thus allowing them to regulate tax burden accordingly in a respective state. Tax benefits are the principal mechanism for SME support in the USA in terms of taxation.

Table 1
Underlying taxes levied at the appropriate State level

Federal taxes	Personal income tax
	Corporate income tax
	Excise levies
	Customs duties
	Inheritance tax and gift tax
	Social insurance contributions
Regional taxes	Personal income tax
	Corporate income tax
	Sales tax
	Excise levies
	Vehicle tax
	Property tax
Local taxes	Personal income tax
	Corporate income tax
	Inheritance tax and gift tax
	Property tax
	Environmental tax

Source: U.S. Taxes in 2020.

URL: <https://iqdecision.com/nalogi-v-soedinennyh-shtatah-ameriki-v-2020-godu/> (In Russ.)

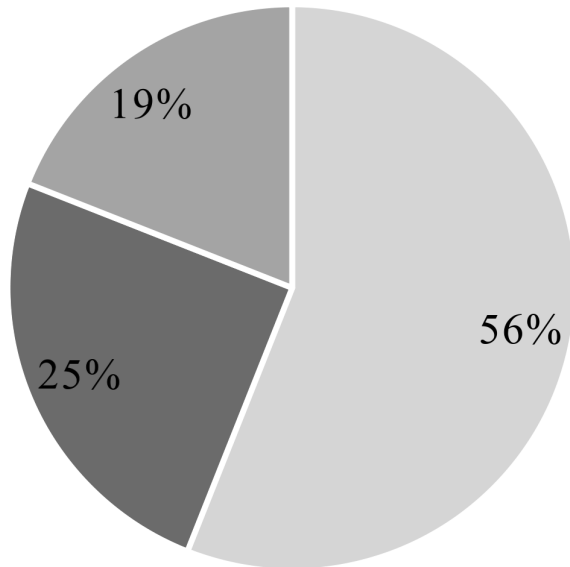
Table 2
Capital gains tax rates in the USA

Tax rate, %	Share of certain people, USD	For married filling a common tax return, USD	For married filling separate tax returns, USD	For heads of households, USD	For entities and trusts, USD
0	40 000	80 000	40 000	53 600	2 650
15	441 450	496 600	248 300	496 050	13 150
20	from 441 450	from 496 600	from 248 300	from 496 050	from 13 150

Source: U.S. Taxes in 2020.

URL: <https://iqdecision.com/nalogi-v-soedinennyh-shtatah-ameriki-v-2020-godu/> (In Russ.)

Figure 1
Percentage of total taxes levied by federal (56%), local (25%) authorities, and authorities of the states (19%)

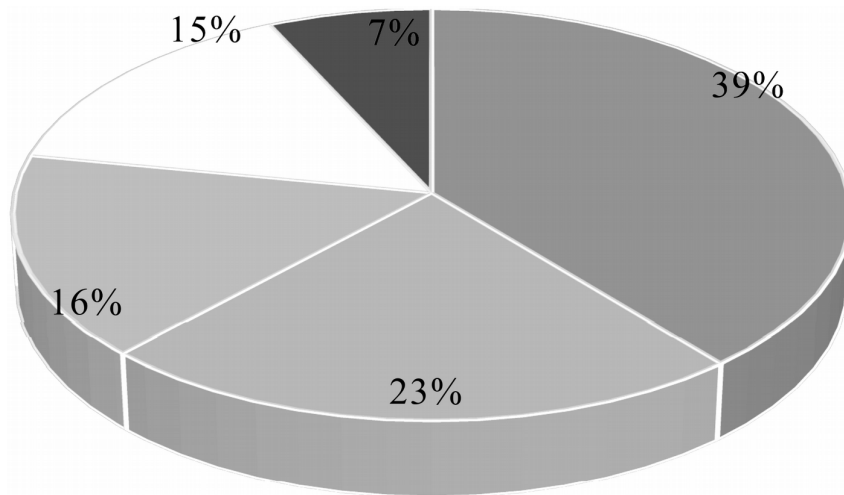


Source: U.S. Taxes in 2020.

URL: <https://iqdecision.com/nalogi-v-soedinennyh-shtatah-ameriki-v-2020-godu/> (In Russ.)

Figure 2

Percentage of tax revenue: personal income – 39%, social security – 23%, sales – 16%, real estate – 15%, corporate taxes – 7%



Source: U.S. Taxes in 2020.

URL: <https://iqdecision.com/nalogi-v-soedinennyh-shtatah-ameriki-v-2020-godu/> (In Russ.)

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Conflict-of-interest notification

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